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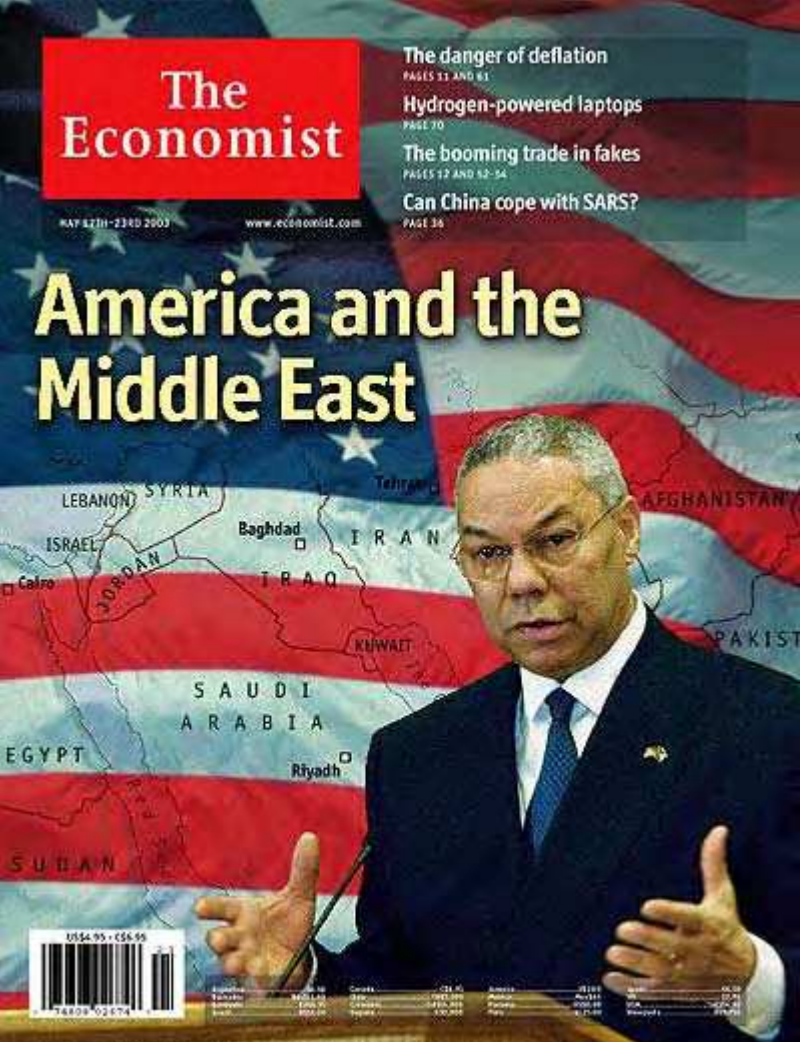

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Politics this week

May 15th 2003
From The Economist print edition

Terror in Saudi Arabia

Reuters

In Riyadh, **Saudi Arabia's** capital, nine suicide bombers rammed their vehicles packed with explosives into three compounds housing expatriates, killing at least 34 people, seven of them American. President George Bush blamed the al-Qaeda terrorist network, and vowed to hunt down those responsible.

See article: Terrorism strikes home

Remains of up to 3,000 people were found at a **mass grave** south of Baghdad. One estimate was that there could be as many as 11,000 people buried at the site.

See article: Questions in the aftermath

At least nine Iraqi children were killed after an **unexploded rocket** detonated in southern Iraq.

America engineered another round of regime change in **Iraq**. The Bush administration showed its frustration with the slow pace of the reconstruction and replaced Jay Garner, a retired general, as chief American administrator for Iraq. He is succeeded by Paul Bremer, a former head of counter-terrorism at the State Department. Barbara Bodine, a former ambassador to Yemen, was also relieved of her role of running the Baghdad region.

See article: Post-war reconstruction

Plaintiffs in Belgium filed a lawsuit against Tommy Franks, America's commander in the Gulf war, accusing him of **war crimes**. Belgium's foreign minister called this an abuse of his country's “universal competence” law.

Colin Powell, America's secretary of state, visited Israel, the Palestinian territories, Jordan, Egypt and Saudi Arabia to promote the **road map**, the plan for a Middle Eastern peace agreement. Substantive progress will have to wait until Ariel Sharon, Israel's prime minister, visits George Bush next week.

See article: Peace and broken promises

Somalia's transitional government, which has little or no control over the warring country it is supposed to rule, was shut out of its parliament building for non-payment of rent.

The Algerian army rescued 17 European tourists who had been **kidnapped** by Islamist militants in the Sahara desert. Another 15 tourists are still missing.

Ethnic militias fought in **Bunia**, an eastern Congolese town from which the Ugandan army recently withdrew. After indiscriminate killing, thousands sought refuge inside a besieged United Nations barracks.

See article: A massacre in Congo

Still in the axis

North Korea said that America's decision to keep it on a list of sponsors of terrorism was intended to provide a pretext for an attack on the country. But in Washington George Bush and South Korea's President Roh Moo-hyun stressed the need for diplomacy to achieve the “irreversible elimination” of the North's nuclear weapons.

See article: South Korea's President Roh goes to Washington

AP

Singapore reported a possible outbreak of the deadly disease SARS at its biggest hospital for the mentally ill, dashing hopes that the country was now free of infection. **Taiwan** said it feared that the disease had spread to the south of the island. **China**, where SARS was first detected, announced its lowest daily tally of new cases, but was worried that the disease was spreading to rural areas. It threatened to execute anyone who breaks a quarantine order.

See article: Guarding rural China

In the latest in a series of **mining accidents** in China, at least 81 people were killed by an explosion in a coal mine in Huaibei, in the east of the country. Last year about 7,000 people died in mining accidents in China.

France stands still

AP

A general strike against government plans to reform **France's** generous pension system paralysed communications and much else in the country. But so far Jean-Pierre Raffarin's government has shown little readiness to give much ground.

See article: France's trade unions challenge pensions reform

Suicide attackers drove a truck laden with explosives into a complex of government offices in Znamenskoye, in northern **Chechnya**. The blast killed at least 54 people. Two days later, another suicide attack in another city killed at least 14 people.

Having stuck, if unhappily, to her post throughout the Iraq war, Clare Short, **Britain's** overseas development minister, resigned; the UN had not been allowed a big enough post-war role, she said; and Tony Blair was too presidential by half, governed by diktat and should quit.

See article: The resignation of Clare Short

Europe's longest-serving prime minister, **Iceland's** conservative leader, David Oddsson, won a general election but still needs to find a coalition partner (possibly the Progressives, as before) to extend his current 12-year span in office.

See article: Iceland's record-breaking prime minister

Little over 60% of **Lithuanians** turned out for a referendum on membership of the EU. But of those who did, some 90% said yes.

A study in Britain showed that demand for **Viagra** and similarly stimulating drugs dropped sharply during football's World Cup last year.

Running from office

More than 50 **Texas** Democratic politicians fled the state to prevent the Republicans who now control their state from getting a quorum to pass a redistricting law that would give them more congressional seats.

See article: Looking for Texan Democrats

Calling the episode “a low point” in its 152-year history, the *New York Times* sacked a **journalist** for inventing and plagiarising stories.

See article: Hard times at the New York Times

Menem pulls out

Having wavered for days, ex-president Carlos Menem withdrew from the presidential race in Argentina. His withdrawal cancelled the second round of the elections, due on May 18th, and left **Néstor Kirchner**, the favourite, with a non-mandate to sort out the region's most troubled economy, since he had won fewer than a quarter of the vote in the first round.

See article: Kirchner wins Argentina's election by default

The United States expelled 14 **Cuban diplomats** from missions in New York and Washington, DC, for “unacceptable activities”. Cuba called this “an irrational act of revenge”, but announced no retaliatory measures.

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Business this week

May 15th 2003
From The Economist print edition

The GM gamble

The United States (with Argentina, Canada and Egypt) is to challenge the European Union's moratorium on **genetically modified food** at the World Trade Organisation. It contends that blocking imports of American crops has no scientific basis. The move came a week after the EU said that it would impose trade sanctions over America's tax treatment of exporting firms.

See article: America's WTO challenge to Europe

The European Court of Justice ruled that "**golden shares**" held by the governments of Britain and Spain in six firms are illegal. The shares give the governments the power to block takeovers of privatised companies. The EU'S next probable target: the German government's defences of Volkswagen.

The colour of money

EPA

The United States unveiled the first of its redesigned **dollar bills**, with added security features to baffle forgers, including the addition of extra colours. The $20 note, due to begin circulating in the autumn, might perhaps become known as the "subtle green, peach and blue" back.

See article: Why counterfeiting is bad for everybody

The **dollar** fell further against both the euro and the yen, after remarks by John Snow, America's treasury secretary, in a TV interview. His statement of the obvious—that a weaker dollar helps exporters—was interpreted as another sign that America's commitment to a "strong dollar" may be fading. Meanwhile, Germany and Italy reported that their economies had shrunk in the first quarter.

See article: Bouncing around

Store wars

Jim Miller resigned as chief executive of **US Foodservice**. In February it emerged that profits at the subsidiary of Ahold, a struggling Dutch retailer, had been fraudulently overstated—by $880m over three years. Investors have been calling for his head ever since.

See article: The murkiness of retailing

Sales began at Britain's best-known department stores. Swanky **Selfridges** accepted an offer of £598m ($969m) from Galen Weston, a Canadian retailing magnate, but a counter-offer looked likely. The more downmarket **Debenhams** considered an offer of £1.5 billion from Permira, a British investment fund; other bidders could yet emerge.

See article: The pros and cons of family businesses

Wal-Mart bucked the trend for America's struggling retailers with quarterly profits of $1.9 billion, up by 14% on a year ago. But it decided to stop selling three "lad" magazines—*Maxim*, *Stuff* and *FHM*—because

of their raunchy content. More typically, **J.C. Penney's** profit fell by 29% to $61m.

SABMiller, the acquisitive South African firm that has become the world's second-biggest brewer, paid some *euro*246m ($283m) for a majority stake in Italy's second-biggest brewer, Birra Peroni, with a view to a full takeover.

Musical ensemble

Bertelsmann discussed merging BMG, its music arm, with **AOL Time Warner's** Warner Music. Meanwhile, **Universal Music Group** joined a lawsuit brought by music publishers against the German media giant, alleging that its relationship with Napster, an internet file-sharing service, encouraged copyright infringement.

Sony zapped **Nintendo's** shares with the surprise announcement that it would launch a handheld games-console to challenge its rival's Game Boy. Sony's shares shot up on the news that it would try to emulate the success of PlayStation in a portable form.

News Corp made a profit in the first quarter, earning $275m compared with a loss of $4 billion a year before. Rupert Murdoch denied that he had plans to enlarge his media empire dramatically, despite a probable relaxation of media-ownership rules in America; he also denied any plans to buy Britain's Channel 5.

Philip Anschutz became the first client of Wall Street's investment banks to settle investigations into the buying of tech shares in the boom years. The founder of Qwest Communications gave up $4.4m of profits from the "**spinning**" of initial public offerings.

UBS reported first-quarter profits down by 11% on a year ago, to SFr1.2 billion ($878m). Peter Wuffli, the Swiss bank's president, said hopefully that "it is starting to smell like the end of the bear market."

Grey skies

Lufthansa said that SARS, war in Iraq and a sluggish world economy constituted the industry's "greatest economic crisis ever" and announced a first-quarter loss of *euro*356m ($382m). **Air Canada** reported mounting losses and the grounding of 40 planes.

Cathay Pacific revealed that passenger numbers in April had fallen by 66% over a year ago and said it saw no signs of an end to the problem. **Japan Airline Systems** cut capacity by 22%. **Singapore Airlines** is to give out free "health kits" including masks and thermometers to protect passengers on some routes.

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America and the Middle East

May 15th 2003
From The Economist print edition

After the Saudi bombs, the main job is still to get Iraq right

"CASE proven—war does not eradicate terrorism." So said a London newspaper after suicide bombers, presumed to be from al-Qaeda, killed scores of civilians in their beds in Riyadh this week. Many people who opposed the invasion of Iraq will be tempted to agree. Wasn't one argument against the war that deposing Saddam Hussein would add to the rage that feeds Muslim terrorism? Much the same was said after the bombings in Bali last October. They were held up as evidence that America had achieved nothing by removing the Taliban in Afghanistan, and that George Bush's obsession with Iraq had diverted attention from the war against terror.

The limits of foreign policy

Such arguments are misconceived, to say the least. It would be a comfort to believe that Islamic terrorism rises and falls with each twist and turn of American foreign policy. If so, America would need only to adjust its policy for the terrorism to stop. But its causes are more complicated than that. Here and there (Palestine, Kashmir, Chechnya) it stems from a Muslim struggle against non-Muslim rule. Often (Saudi Arabia, Egypt, Algeria) it arises from the desire of Muslims to throw off their own governments because they are seen as corrupt, repressive or insufficiently pious. And sometimes (al-Qaeda) this local struggle mingles with the idea that Islam is locked in perennial *jihad* against the unbelievers. Muslims who think this way, says Bernard Lewis, one of Islam's foremost interpreters in the West, will see any American president as the successor of a long line of rulers, from the Byzantine and Holy Roman emperors to Queen Victoria, who have obstructed the divinely ordained spread of the true faith.

Violent hearts captured by this sort of worldview will not be dissuaded by this or that adjustment in foreign policy. Mr bin Laden's 1998 declaration of war against "Crusaders and Jews" came at a time of relative optimism in Israeli-Palestinian peacemaking. This week's bombs came less than a month after America said it would remove most of its forces from Saudi Arabia. Al-Qaeda will continue its attacks even if America pushes hard for peace in Palestine (see article), and it would not have stopped its attacks even if America had decided against invading Iraq. As for Afghanistan, there is every indication that the loss of its safe haven has indeed disrupted al-Qaeda's ability to operate. Many of its top men have been killed or captured. The fact that it has nonetheless struck so hard in Saudi Arabia shows only that the war against terrorism will never produce a single, decisive moment of victory.

In one way, Mr Bush himself has been guilty of promoting the illusion that it might. He found it convenient before invading Iraq to exaggerate—some say to fabricate—a link between Saddam and al-Qaeda. This was the weakest part of the case for an invasion. The strong case was the threat Saddam

would have posed with chemical, biological or one day nuclear weapons. His refusal for a dozen years to comply with Security Council demands to prove that he no longer had such weapons and was no longer seeking them was ample justification for the war. In fairness, Mr Bush added another: the dictator's brutal treatment of his own people. This week's discovery of yet another mass grave, containing up to 11,000 executed civilians, ought to give pause to those (including *The Economist*) who would have been content to leave Saddam in power if he had complied with his disarmament obligations. But having portrayed the Iraq war as part and parcel of the war on al-Qaeda, Mr Bush has only himself to blame if the Saudi bombs are seized upon as evidence that the war has failed.

What next? The Saudi bombs do not show that America is losing the peace in the Middle East. But, of course, it may lose the peace. Whatever the reasons for its war, victory in Iraq has given America an opportunity to build an exemplary democracy and to stabilise the wider region. Neither of these jobs was ever going to be easy. The implosion of a three-decades-old dictatorship could not fail to leave a mess. The ruling party has been abolished at the stroke of a pen, leaving chaos behind it. Contrary to the forebodings of those who say that Arabs cannot be democrats, the appetite for democracy looks strong. Many Shia clerics, including those returning from Iran, endorse the idea of elections, albeit with an Islamic flavour. But democracy of any sort requires order, and the occupying powers have so far been slow to provide either order or the necessities of civilised life, such as electricity and clean water.

The power of example

Even allowing for the scale of the task, it is becoming plain that America and Britain planned less well for the post-war transition than for the fighting. Now they have introduced a resolution in the Security Council under which they and not the United Nations will have final control as the country moves towards democracy. That might be justifiable, if it were a case of sacrificing some international legitimacy for greater efficiency. The danger—unless the new transition team Mr Bush has sent to Iraq to replace his first lot does much better—is that the occupation will come to look neither efficient nor legitimate. At the very least, given the continuing suspicion of their motives, America and Britain ought to let the UN monitor the hunt for Iraq's missing weapons of mass destruction—the prime cause of war—and check the authenticity of any finds.

It is impossible to overstate the importance of getting Iraq's transition right. There are plenty of other ways for America to win Muslim hearts and minds. The superpower could be less uncritically supportive of autocratic regimes such as Saudi Arabia's. It should work harder for Mr Bush's two-state solution in Palestine. But the power of its own example in Iraq may well count for more. Iraq has the human and raw material it needs to become a prosperous liberal democracy. Guiding it there, and then leaving it in peace, is not enough to make America safe from continuing attacks by implacable *jihadis* of the al-Qaeda sort. But the mere existence of a democratic Iraq would help to persuade millions of Muslims that the alternative to a secular dictatorship does not have to be an Islamic dictatorship—or any sort of dictatorship at all.

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America and Israel

It's the settlements, stupid

May 15th 2003
From The Economist print edition

What George Bush should say to Ariel Sharon

Reuters

Get article background

"WE ARE not travelling to a place where there are pressures," Ariel Sharon growled comfortably to the *Jerusalem Post*, as he prepared for his visit to America next week. Israel's prime minister may be right in his confidence. In the interests of peace, it must be hoped he is wrong.

Mr Bush and Mr Sharon will be discussing the road map, the phased proposals offered by the United States and others for ending the Israeli-Palestinian conflict by 2005. The Palestinian Authority has accepted the map. The Israeli government insists that it be changed (see article). If the matter is to be settled, it will be in Washington. And Mr Sharon seems sure that Mr Bush will finesse any difference in views.

The plan's time sequence allows for a certain fuzziness. The timetable is unrealistic, and the instructions offer the Israelis leeway on how much to do and by when. But for the process to have a chance, Mr Bush must steel himself to exert superpower pressure on two points.

The first of these is the map's call for Israelis and Palestinians to move in parallel. The Israelis insist that the Palestinians must go first; they cannot, they argue, withdraw their army until they can trust Palestinian security forces to protect Israeli interests. This seems fair. But the flaw is that the Palestinian government's ability to fight terrorism depends on its being able to convince its core supporters that it is in their interest to work with the Israelis. Taking on the hard men of Hamas or Islamic Jihad calls for the full co-operation of the mainstream movement, Fatah. And that co-operation is unlikely until the Palestinians have evidence—some freedom of movement, say, or an end to the demolishing of houses—that Israel is dancing to roughly the same peace music.

It would be a shame if Mr Sharon manages to wheedle Mr Bush away from the logic of simultaneous Israeli-Palestinian action with warm banalities about the two men's shared anti-terrorist determination. But even Mr Sharon cannot call up the spectre of Israeli lives at risk when Mr Bush, as he surely must, brings up the second great sticking-point: Israel's refusal to accept the plan's freeze on Jewish settlements. Here, the road map is specific. Israel, it says, should immediately dismantle outpost settlements erected since March 2001, and freeze all settlement activity, including their natural growth. Some 70 "illegal" outposts have been set up in the two years since Mr Sharon became prime minister,

and the area of existing “legal” settlements has been hugely increased.

Yet Mr Sharon appears as confident about retaining the settlements as he is about retaining America's pussy-cat relations with Israel. The settlements issue, he says grandly, is “not on the horizon”. His explanation? All previous Israeli governments had gone ahead with settlement-building, even during periods of peace diplomacy. So they had, and this is one prime reason why all such efforts have failed. During the seven years of the Oslo peace process, the settler population almost doubled, and there was a vast increase in the settlements' territorial reach. This helped to undermine the whole peace process in Palestinian minds, contributing to the general, self-destructive resistance to the proposals that eventually emerged from Camp David. All in all, it is a rotten precedent.

Mr Bush should tell Mr Sharon that the map is not a draft for Israeli corrections. Unless he takes on Israel's formidable prime minister, the poison from the Israeli-Palestinian conflict will continue to leach its way to America.

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America's nuclear weapons

Ban the mini-bomb

May 15th 2003
From The Economist print edition

Why some weapons are best left unexplored

Get article background

THEY are, says George Bush, some of “the world's most dangerous weapons”. Earlier this month his diplomats were urging members of the Nuclear Non-Proliferation Treaty (NPT) both to tighten up the rules against the spread of nuclear weapons and to deal more strictly with rule-breakers. To show that America was doing its disarming bit too, as required by the treaty, they told of the cuts being made to existing weapons stockpiles and efforts to deal safely with fissile materials no longer needed for bombs. So why are Mr Bush's military planners now pressing Congress to lift its decade-long ban on research into low-yield nuclear weapons, or “mini-nukes”?

Research, of course, is not full development, testing and deployment, all of which would need more cash and therefore further congressional approval. Nor would it be illegal for any of the five nuclear powers recognised by the NPT to work on new warhead designs (China is tinkering with lighter warheads so as to be able to mount several on one rocket, as others do). Yet America's proposed nuclear dabbling is not only unnecessary, it could ultimately prove self-defeating.

Those who would lift the mini-nuke ban rely chiefly on two arguments. One is that such weapons would actually enhance deterrence, which can work only if it remains credible. This is a genuine problem. If a mega-bomb were America's only possible answer to a future threat, might it not end up giving itself more pause than the enemy? Possibly. So, if America's nuclear weapons are to continue to deter, there needs to be a reasonable range of them—but thankfully that is something America's nuclear laboratories can already provide.

The other argument deployed on behalf of mini-nukes is that they could be the ideal weapon for going after deeply buried stashes of chemical and biological weapons, of the sort roguish regimes and terrorist groups like al-Qaeda might attempt to conceal. America is already considering adapting existing warheads for such “bunker-busting” jobs. But wouldn't earth-penetrating weapons with much lower yields (under five kilotonnes) be even better, since their lower yield would surely make them politically more acceptable to use?

A dangerous detour

Low yield is not no yield. Unless it somehow managed to burrow a very long way down before exploding, such a weapon detonated beneath the earth's surface would throw up huge amounts of radioactive debris, a danger to all. Better to keep working out how America's increasingly powerful and accurate conventional weapons can do the bunker-busting. Still more dangerously, by treating nuclear weapons as just another explosive in the arsenal, rather than as a deterrent weapon of last resort, America would dangerously blur the line against nuclear use by anyone. That would make it more likely, not less, that America's own forces would eventually have nuclear weapons used against them too.

It makes no sense for the country with easily the world's most powerful conventional weapons to hand its enemies an excuse to go for the great equaliser against it. Nor does it help Mr Bush persuade NPT waverers to keep on renouncing all nuclear ambition if his own defence planners are busily inventing new

jobs for nuclear weapons to do, and new nukes to do them with. And here lurks another danger: the further research goes into new types of nuclear weapons, the greater the pressure there will be for explosive tests to prove that they can work. Yet a test-ban—something Mr Bush has so far said he will stick to, even though he rejects the treaty that would back up the ban—was part of the deal that won the indefinite extension of the NPT. Weaken one side of that bargain, and America will weaken the treaty itself.

Mr Bush has said repeatedly, with reason, that he wants America to rely less on nuclear weapons for its future security, not more. In their determination to leave no weapons avenue unexplored, his advisers are proposing to lead America along a dangerous path. Time the president called a halt.

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Economic policy

The joy of inflation

May 15th 2003
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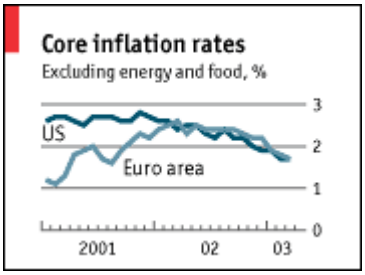
Central banks have beaten inflation—but it may now be too low, not too high

INFLATION in the developed world is at its lowest in almost half a century. This should be a moment of triumph for inflation-busting central banks. Yet instead, many economists are fretting that they have succeeded too well. Prices have been falling in Japan since 1995; in America and Germany the risk of deflation is greater than at any time since the 1930s. The longer growth remains below trend, the further inflation will fall. History argues that, once entrenched, deflation does a lot more damage than inflation, and is also far harder to defeat. But today's central bankers may be ill-prepared to fight it off. None more so than the European Central Bank (ECB).



Recent statements by both America's Federal Reserve and the ECB signal that they recognise the danger of deflation, even if they still consider it a minor risk. So can they, unlike the Bank of Japan, prevent deflation? The biggest problem is that nominal interest rates cannot go below zero; if prices fall, this can make it impossible to deliver the negative real rates necessary to boost demand. Interest rates in America (1¼%) are already closer to zero than in the euro area (2½%), which might suggest that America is at greater risk of deflation. However, monetary conditions in the United States are being loosened by the falling dollar. The Fed also seems readier than the Bank of Japan was to adopt unorthodox monetary measures if need be. The same cannot be said of the ECB, which also faces a rising euro. A weaker dollar may thus export deflation to Europe. That makes the ECB's present reluctance to cut interest rates even harder to excuse.

A more fundamental question is whether central banks might themselves have aggravated the risk of deflation, by aiming for a needlessly low target for inflation. Everybody agrees that high inflation is bad for growth, because it distorts relative prices and hence the allocation of resources. But there is room for disagreement about how low inflation ought to be. There is little evidence that pushing inflation below, say, 3% will raise growth. Indeed, there is plenty of academic support for the view that a little bit of inflation is better for growth than none at all.

One reason is the danger of deflation. A study by the IMF concludes that, given the range of economic shocks over the past 40 years, the risk of interest rates hitting zero and deflation setting in rises markedly once an inflation target is set below 2%. This suggests that the mid-point of any target should be above 2%. The ECB regards 2% as its ceiling.

Disperse and rule

The appropriate inflation goal for the euro should in any case be higher than for the United States, because of Europe's wider dispersion of inflation rates. The introduction of a single currency causes prices in different countries to converge: inflation is likely to be higher in fast-growing, low-cost countries, such as Spain and Ireland, than in slow-growing, high-cost countries, such as Germany (see article). The ECB's target of below 2% may therefore condemn Germany to average inflation of 1% or less. Since official figures tend to overstate the true inflation rate, that is dangerously close to deflation. When newcomers from central and eastern Europe join the euro, the ECB's target will make even less sense. The new entrants have far lower incomes than existing members, and, as they catch up, they will have higher inflation. Today's inflation ceiling will then imply even lower inflation in Germany.

Another argument for a little bit of inflation is that it can smooth the path of adjustment. If inflation is 3%, workers might accept a pay freeze, implying a real pay cut of 3%; but if inflation is zero, they may

not accept a 3% nominal pay cut. Without some inflation, it is hard to trim real wages in a declining industry or region, meaning that unemployment will rise. The less flexible a country's labour market, the higher its optimal inflation is likely to be: and Europe's are notoriously inflexible. All in all, if the appropriate rate for America is 2-3%, say, then in the euro area it might be 3-4%. Instead, the ECB has the lowest inflation target of any central bank in the world.

A decade or so ago, when inflation still loomed large, some (including *The Economist*) argued that 0-2% was the right inflation goal for central banks. Seeking a little bit of inflation was, after all, like wanting to be a little bit pregnant: it could quickly get out of hand. At that time, when the priority was to reduce inflationary expectations and deflation was confined to dusty old textbooks, this made sense. Today, with Japan so clearly demonstrating the perils of deflation, central banks need to aim a little higher.

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About sponsorship

Counterfeiting

In praise of the real thing

May 15th 2003
From The Economist print edition

What countries and companies should do about counterfeiting

Reuters

SAMUEL JOHNSON once observed that no man had yet become great by imitation. Perhaps not; but many have become rich that way. Counterfeiting is a profitable business: it needs no R&D and no expensive advertising campaigns. Just copy a popular product, sell it at a discount and rake in the returns. This simple business model, when combined with new technologies, free trade and the rising value of brands, is opening a far broader range of consumer goods and markets to enterprising copycats (see article). True, the practice is illegal in much of the world, but the penalties for doing it are light compared with, say, dealing in illicit drugs. Why bother trafficking in heroin when counterfeit Viagra can bring comparable profits without punishment?

Companies that have spent millions creating their brands (and defending them against competition) are not flattered by such imitation. They want iron-clad protection against counterfeits. While it is still possible to find a fake in London or New York, the real hotspots of making and selling counterfeits are in poorer places—such as China, the Philippines or India. This is not surprising. Countries tend to build their industrial base by copying others; look back a century or two and many of today's staunch defenders of intellectual-property rights (IPR) in Europe and America were busy doing exactly the same.

Developing countries no longer have the luxury of taking their time to respect copyright, patents, trademarks and other IPR. All but the poorest members of the World Trade Organisation have until 2006 to implement TRIPS, an international treaty setting out minimum standards for IPR and for enforcement. Many developing countries have introduced laws protecting IPR, but in practice protection is often weak. Fighting counterfeiting calls for clear rules on enforcement; trained police and judges; customs officials with the inclination and authority to check exports and seize suspected counterfeits; and a willingness to put counterfeiters in the dock and out of business with stiff, even criminal, penalties.

None of this comes cheap. Governments in many poor countries take a strong line against counterfeiting when it involves their own currency or the output of a state monopoly (such as tobacco). But they tend to turn a blind eye to most consumer-goods piracy. In many cases, counterfeiting provides a boost to the local economy and, sometimes, more directly to local officials' wallets. Such myopia, however, is not in countries' long-term best interests. Clamping down on counterfeits is not just good for foreigners and their investments. It gives a boost to domestic industry and encourages it to come up with innovations that are themselves worthy of protection.

More than a matter of handbags

While firms are clamouring for governments to take action, they could be doing a lot more on their own account to fight counterfeiting. Too few devote enough money (and top managers' attention) to the issue. One priority, particularly for companies with manufacturing scattered across the globe, should be to tighten their grip on supply chains—with stricter contracts, regular monitoring of contractors, and the use of tracking technologies—to ensure that their precious goods (and know-how) are not going astray.

Many firms, among them drugmakers and food processors, are reluctant to admit publicly that they have a problem with counterfeiting, in part for fear of alarming consumers and undermining their market share. But the battle against counterfeits is, in some ways, rather like the war on drugs: closing down the factories and taking out the dealers will have little effect so long as demand stays high. Industry lobby groups are keen to overcome the general impression that counterfeiting is a harmless game, merely a matter of cheap handbags. But to do this, they must acknowledge problems in the very areas where they are most afraid of creating panic.

In the process, however, firms should take care not to exaggerate their predicament. Consumers are rightly sceptical of, say, pharmaceutical firms that try to shut out competition from imports by claiming that anything that loosens their grip on the market will bring a tide of counterfeits in its wake. The arguments against counterfeiting are best made with sound statistics, not scare stories.

In the end, the companies best placed to fight counterfeiting are those that see it as a challenge, not just a curse. Counterfeiting should prompt executives into asking awkward, but vital, questions about how to enhance their brands' consumer value and improve customer relations. Firms which innovate to stay one step ahead of the pirates deserve full protection against counterfeiting; consumers have to hope that the same spirit of competition will prevail once the copycats have scurried back into the shadows.

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Letters

May 15th 2003
From The Economist print edition

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Accurate accounts

SIR – You say that the majority of accountants believe they exist to "give a true picture of a company's performance during a particular period of time" ("True and fair is not hard and fast", April 26th). This overlooks the simple basis upon which accounting was founded: to account for transactions.

Transactions begin and end on specific dates, which coincides nicely with the concept of historical cost and "hard and fast" figures. If you ask an accountant to prepare reports that are not clearly based on transactions (eg, accounting for stock options or pro-forma accounts) you enter a different field. While I sympathise with investors who desire a "sense of the company's future prospects", this service is currently better left to financial analysts and fortune-tellers.

Adam True
New York

SIR – The supposed superiority of market value over historic cost, so favoured by Sir David Tweedie, chairman of the International Accounting Standards Board, is riddled with problems. Two obvious questions arise: which market and which value? Are the assets of a business to be valued in their present location and use (their worth to the firm), at second-hand or even scrap value? Is the valuation to be made before or after removal, transport and dealing costs? By the time all the required assumptions are built in, the so-called market value is about as useful as the historic cost.

Paul Hayward
Bedford

SIR – Peter Holgate of PricewaterhouseCoopers is reported as asking why corporate earnings move up in a straight line while the drivers of those results bump around much more unevenly. The answer seems blindingly obvious. Members of Mr Holgate's profession have allowed them to do so.

R. Sankar
New Delhi

Good news

SIR – Greg Dyke is indeed right to spot a lucrative market for BBC news programming in America (Face value, May 3rd). However, it is not because some Americans are looking for an "offshore" or "anti-American" perspective, as you claim. Rather, the television-news market is lopsided: most TV news is oriented toward entertainment rather than sober analysis. The BBC's opportunity lies in an unmet demand for serious news. I like the BBC's "scruffy, sceptical Brits", and have never known them to be anti-American. If I want cheerleaders, I'll watch a football game.

Kevin Duncliffe
West Hollywood, California

Big air?

SIR – You endorse the conventional view that the airline industry's fragmentation is at the source of its

sorry state ("A way out of the wilderness", May 3rd). While consolidation is overdue—particularly in Europe—the conclusion that it will restore profitability "not unlike in the car industry" seems a leap of faith.

First, America's airline market is by far the biggest and most consolidated, yet it is suffering the most; the two largest participants are in or near bankruptcy. Second, the car industry is not a vibrant example of the merits of global consolidation judging by its long-term share performance. In fact, as with airlines, the companies that perform best are relatively small. Mergers may be necessary but are no substitute for strategy.

Robert Tasiaux
Brussels

From nature

SIR – You significantly misrepresent *Nature*'s position with regard to our publication of the anthrax genome ("Publish and perish?", May 3rd). You falsely allege that, in apparent contradiction of an editorial statement on such matters, we had undertaken no consideration of the risks associated with publication. On the contrary, well before that editorial statement was published and well before the anthrax genome was submitted anywhere for publication, I consulted researchers close to defence services about this genome and encountered only unequivocal support for its publication in a journal. We bore these points in mind after the authors subsequently chose to submit it to *Nature*.

Philip Campbell
Editor-in-chief
Nature
London

Reading the road map

SIR – I am deeply disappointed that you say American pressure on Israel is the necessary element for progress in resolving the Israeli-Palestinian conflict ("George Bush's risk for peace", May 3rd). This ignores the realities of the situation. At the time you wrote this, Yasser Arafat was undermining Mahmoud Abbas's control of Palestinian security forces even as Mr Abbas was indicating that he would not directly confront Palestinian factions dedicated to Israel's destruction.

When the Palestinians are serious about curbing Hamas, Islamic Jihad and the rest of the Palestinian terror groups, the Israeli centre will rapidly force its government into concessions that will result in an equitable settlement. Until the Palestinians are serious about stopping terrorism, no amount of American pressure will move the Israeli government or its people.

David Prohofsky
River Forest, Illinois

SIR – I am one of many Arabs who sees the road map as an unprecedented opportunity to resolve Israel's conflict not only with the Palestinians but also with Syria and Lebanon. The standing of its architects makes it a credible expression of serious intent. Its target dates for parallel moves make it a sensible action plan with a clearly defined end-game.

To get the parties going on implementation, it is crucial that the architects, with America in the lead, resist Israel's manoeuvres to turn the road map into a negotiating paper. If this happens, the effort to resolve the conflict will fail. Mr Abbas cannot build popular support for his peace strategy, rein in Hamas and other militant groups, and end acts of violence against Israelis, if Israel does not concurrently freeze all settlement activity and take immediate steps to normalise Palestinian life. These moves, which Israeli government spokesmen are already saying would reward terrorism if they are taken before Mr Abbas succeeds, are the moves without which he has no chance of succeeding.

S.A. Sherif
Montreux, Switzerland

Saudis shun terror

SIR – I take issue with your article suggesting that Saudi Arabia has “a role in financing Islamic extremism”, implying, by linking this to the events of September 11th, that the kingdom supports terrorism (“Ciao, Saudi”, May 3rd). We do not and never have. The government of Saudi Arabia has repeated on more than one occasion its absolute stand against terrorist activities of all kinds and has co-operated with all international efforts, through the UN and other organisations, attempting to deal with the problem. We will continue to do whatever we can, as we always have, to bring any and all terrorists to justice. This is an aim we share with the American government, which remains, despite your attempt to suggest otherwise, a good friend and ally.

Turki Al Faisal
Saudi Arabian ambassador
London

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After the war

The moment of truth

May 15th 2003 | CAIRO
From The Economist print edition

Reuters

Saudi Arabia wakes up to the reality of al-Qaeda

Get article background

THE suicide bombing of three Riyadh housing compounds bore all the hallmarks of Osama bin Laden's al-Qaeda group. The attacks targeted “infidel” western civilians. They were multiple and simultaneous, meticulously planned, and ruthlessly executed. They were also deadly, leaving at least 34 dead (including the nine bombers) and 190 injured. The carnage would have been worse still if 50 of the 70 residents at the worst-hit building had not been away on a training mission.

By the measure of immediate pain inflicted, the operation was a success. Yet the greater long-term damage may be to al-Qaeda itself. The Riyadh attacks have sparked a furious backlash against Mr bin Laden's tactics and ideology, in one of the few countries where these retained a measure of popular appeal. Some Saudis believe that the attacks may help heal the rift between their country and America that al-Qaeda has long sought to exploit.

Since the 2001 attacks in New York and Washington, DC, al-Qaeda has lost its network of bases around the world. American strikes have cleared the group and its associates from Afghanistan, Yemen and Iraqi Kurdistan. Police work has stifled it in Europe, Asia and most Arab countries. Some 3,000 of its operatives are in jail, and two-thirds of its top leaders are thought to have been killed or captured.

Saudi Arabia has been an exception to this pattern of retrenchment, for several reasons. In Mr bin Laden's own homeland, his tale of millionaire-turned-revolutionary still strikes a chord. The mystique touches not only the estimated 10,000 Saudis who fought as volunteers in Afghanistan, but also the country's huge and growing pool of unemployed youths. Smuggling from Yemen and, increasingly, from Iraq has combined with lax policing to ensure a ready supply of guns.

Intolerance has long been embedded in the Saudi state's rigid Wahhabist interpretation of Islam. Disillusionment with the ruling al-Saud family has inspired even more strongly xenophobic trends. Resentment against America has grown in response to America's support for Israel, its invasions of Afghanistan and Iraq, and its perceived hostility to Arabs and Muslims in the wake of the September attacks.

It has also put the al-Sauds on the defensive. Jealous of its pretensions as guardians of Islam, the ruling family has often shied from vigorous pursuit of religious militants, despite a string of violent incidents inside the kingdom that has claimed more than 30 victims, mostly foreigners, since 1995. The minister of the interior, Prince Nayef, has typically preferred to hint that alien forces, rather than Saudis, have been responsible.

Such hesitancy may now be about to end. The country's acting ruler, Crown Prince Abdullah, issued an uncharacteristically stern warning after the Riyadh bombing. Anyone who tried to justify crimes in the name of religion, he said, “would be considered a full partner to the terrorists and share their fate”. Saudi police say they already hold nearly 100 al-Qaeda suspects, and have identified two active cells that remain at large. A raid in Riyadh earlier this month uncovered a large cache of weapons. Security forces are now combing the east of the country.

More helpful than better policing, however, is the turn in public opinion. At least half the victims of this week's attacks were Muslims, seven of them Saudis. Out goes al-Qaeda's contention that it is defending the faith. Meanwhile, last month's announcement that America is to withdraw nearly all its forces in the kingdom, including the 5,000 who man a vast air-command centre near the capital, puts paid to notions that they are an occupying army.

At the same time, the Saudi government has shown increasing readiness to embrace reform. In March, Crown Prince Abdullah welcomed a petition calling for more accountable government. Last week, prominent Shias, representing a long-suppressed community that makes up 5-10% of the population, called for an end to discrimination. The government has yet to act on either request. But the Riyadh bombings have strengthened the hand of those inside the Saudi establishment who would like to crack down on religious extremism, open up to the world, and revive the 70-year-old alliance with America.

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The Middle East road map

With just a few obstructions

May 15th 2003 | JERUSALEM
From The Economist print edition

Ariel Sharon asks for understanding

Get article background

“LET'S get on with it,” urged Colin Powell, America's secretary of state, on his arrival in Jerusalem last weekend to promote the road map, the latest diplomatic plan for ending the Israeli-Palestinian conflict. Israel remained immobile. The Palestinian Authority (PA) has accepted the map, as is. But Israel's prime minister, Ariel Sharon, says his government cannot agree to it as written. Instead, he is going to Washington on May 20th to reach “understandings” with George Bush on Israel's reservations about the plan.

Reuters

Smiling, but not listening

These include Israel's wish to defer any talk of a settlement freeze—which, according to the map, should take place this year—until the planned negotiations on a final settlement in 2005. Mr Sharon is also asking that, in exchange for Israel's recognition of a Palestinian state with “provisional” borders (which, again, is planned to happen by the end of this year), the Palestinians should formally renounce the right of return for the 4m Palestinian now in refugee camps.

In a gesture to Mr Powell, Israel said it would lift part of the “general” closure that prevents 25,000 Palestinians in the occupied territories from working in Israel. However, a day later an extremely tight blockade was imposed on Gaza, which not only barred Palestinians from doing their jobs in Israel, but also stopped journalists, diplomats and foreign-aid workers from doing theirs in Gaza. In a second gesture, Israel freed 180 of the 5,000 Palestinian prisoners now in its jails. But again this sounded more liberal than it turned out: the freed men had been detained for petty offences, such as working illegally in Israel, and many were due for release.

Mr Powell paid public tribute to Mahmoud Abbas, the Palestinians' new prime minister, for the reforms he has got through. But in closed sessions with Mr Abbas, the secretary of state's message was not all that different from Mr Sharon's. He accepted that there could be no actual movement on the road map until the PA had taken “rapid, decisive” action against the militias that now roam free in the West Bank and Gaza. When Mr Abbas questioned Israel's refusal to accept the map, Mr Powell advised him to meet Mr Sharon and discuss matters so that “sufficient agreement can be reached”. Mr Abbas reluctantly agreed, and the first parley between the Israeli and Palestinian prime ministers was tentatively set for May 17th.

Mr Abbas has vowed to end the armed *intifada* through a ceasefire and voluntary disarmament if

possible, but by force if necessary. His difficulty is that neither a truce nor enforcement is likely to work unless Israel also follows the road map's instructions by starting to withdraw from the PA areas that it has reoccupied, and cuts down on punitive actions, such as the military incursion into Gaza on May 14th that left three Palestinian policemen dead.

Israeli settlements present Mr Abbas with a similar problem. He has sold the road map to his people less for the minutiae of its initial phases than for its hoped-for destination: a viable Palestinian state. But that vision dissolves in the face of Israel's never-ending settlement-building. In particular, the Palestinians fear the so-called security fence—a vast barrier of walls, patrol roads, electronic fences and earth trenches—that is being built between Israel and the West Bank, but which, to protect settlements, is also absorbing chunks of Palestinian land, and threatening to swallow much more.

Opinion polls show that most Palestinians, after two and a half years of a violent *intifada* that has cost them dearly in lives, land and jobs, are ready for a mutual ceasefire and a return to talks. But if the new mood is to survive, their new prime minister has to deliver. He is expected to bring about genuine reform of Palestinian institutions, including elections for new leaders. Much harder, and without American intervention impossible, he is expected to see that Israel, too, carries out the instructions of the road map.

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The UN and Iraq

Not happy, not united

May 15th 2003 | WASHINGTON, DC
From The Economist print edition

Security Council members are now bickering over the peace

Get article background

THIS week, the United Nations Security Council met to discuss a draft American resolution which would lift the sanctions the UN imposed on Saddam Hussein's regime and allow money from Iraqi oil sales to flow to reconstruction projects. The proposal threatens to reopen old arguments among the usual suspects. On one side are America, Britain and Spain; on the other, France, Russia and Germany.

Everyone accepts that sanctions imposed on a regime that no longer exists serve no purpose, except to harm the Iraqi people. Both Chancellor Gerhard Schröder of Germany and America's Colin Powell have said they should be lifted. The differences emerge over how to do that.

The resolution sponsored by the coalition of the willing would give UN endorsement to the Anglo-American administration in Iraq, and give it broad control of Iraq's oil revenues. The “coalition of the unwilling” makes two objections. The first concerns money. At the moment, the only way Iraq can sell oil legally is through the oil-for-food programme (OFFP) that the UN runs under the sanctions regime. If sanctions were to go, the programme would disappear into legal limbo.

But around $10 billion of contracts are approved and financed under the programme, with a further $3 billion merely approved. Many of these contracts are with French and—especially—Russian companies. So if sanctions go and the programme vanishes, French and Russian firms stand to lose a lot of money. The draft resolution proposes to phase out the OFFP over four months: too abruptly, its administrator says. One way out of both problems would be for the Americans to guarantee the validity of some outstanding contracts. (The draft resolution would do so only for food and medicine.)

The French and Russians have an interest in reaching agreement because they face an awkwardness to do with timing. The OFFP must be regularly renewed, or it lapses. The current extension runs out on June 3rd. That, as it happens, is the last day of the summit of the G8 (the seven leading industrial nations, plus Russia) in France, which follows an informal gathering of the group in Russia to celebrate the 300th anniversary of St Petersburg. Unless the Security Council agrees to the four-month extension proposed under the resolution, the programme could lapse altogether. The hospitable French and Russians would end up with nothing. And, as the Americans have pointed out, this year's summit would be overshadowed by an unseemly brawl about sanctions.

That might happen anyway, because the other main problem is that the two sides differ over the role of the United Nations—rather as they did during the traumatic debates before the war. France and Russia are reluctant to vote for any resolution which gives the United States too free a hand. America's draft resolution attempts to deal with their objection by having the UN secretary-general appoint a special co-ordinator who would help organise a transitional Iraqi government and would be involved in selecting some of its members. That would then pave the way for UN endorsement of the government, when it is established, which would in turn allow international donors to start lending.

So far, the response to this idea has been mixed. France's president, Jacques Chirac, raised hopes that a deal could be reached when he said that “Voting against a UN resolution to declare war is one thing. Voting on reconstruction and administration is another matter.” But American and British diplomats are unsure whether the French will sign up: as the war was winding down, Mr Chirac threatened a veto over just those issues. Meanwhile, Mr Schröder has insisted that “We want to help rebuild Iraq under a UN roof.” This sounds like something the Bush administration would not accept. There's disagreement, too, with Russia (as Mr Powell found on May 14th) about the return of UN weapons inspectors. Expect

ferocious bargaining—and not much time to strike a deal.

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Post-war reconstruction

False start

May 15th 2003 | WASHINGTON, DC
From The Economist print edition

America's first transition team has failed

Reuters

Bremer in, Garner out

Get article background

POST-WAR reconstruction in Iraq is off to a dreadful start. Looters have plundered food warehouses. Convoys of World Food Programme trucks are shot at; many of the 44,000 UN distribution points have been robbed and closed. There is little clean water, no telephone system and no reliable electricity in Baghdad. Banks refuse to open. Hospitals have been stripped of medicine and ambulances seized and sold in a section of the city that American soldiers call Looterville.

Expectations may have been too high: Iraq was once a prosperous country, and people are impatient for it to be so again. Iraq was also a totalitarian state—and uncertainty, disorder and revenge killings were almost inevitable once state terror was lifted. That said, the occupying forces have undoubtedly contributed, by their mistakes, to the deterioration on the streets. Unless checked, instability and violence threaten to wreck not only humanitarian assistance and reconstruction, but the formation of an interim government as well.

Despite all their planning, the Americans underestimated the scale of forces needed to ensure order. There are around 200,000 troops in Iraq. That sounds like a reasonable number. But most are on other duties, such as searching for weapons of mass destruction. Only 16,000 soldiers are in Baghdad, a city of 5m. Both the speed of victory, and the small, mobile forces employed, meant that the transition from combat to peacekeeping was too abrupt: there was no time to bring in more troops.

This week, the United States took its first step to address the problems with the arrival in Baghdad of Paul Bremer, a former head of counter-terrorism in the State Department, to replace General Jay Garner as head of the Office of Reconstruction and Humanitarian Assistance in Iraq. The office is in some disarray and needs reorganising. But replacing one person is not the main point: the question is whether Mr Bremer will be able to persuade a reluctant Pentagon to free more troops.

Regardless of the numbers, though, the allies have also erred in the manner in which they have carried out peacekeeping duties. Too few soldiers have been on patrol in Baghdad. When they do go out, they drive tanks. (The British tend to stand around, and talk more to locals, but Basra too has problems.) Soldiers did not intervene to stop looters. They did not enforce curfews rigorously. General Garner and his men were holed up in a palace in Baghdad, unable to interact with people because of security fears. This led to missteps, such as the appointment of a minister of health who turned out to be a high-ranking member of the Baath Party.

Depending on whom you talk to, Americans were either afraid that acting as an occupying army would lead to resistance, or they wishfully thought Iraqis would welcome them with open arms. Or the military did not take peacekeeping seriously because it does not “do nation-building”, as President George Bush once said.

But whatever the reason, the light touch, by failing to prevent disorder, has alienated people. Quite a few Iraqis chant “America go home”, but the biggest complaint about the occupation is that it is not intrusive enough. One of Mr Bremer's first acts was to threaten to shoot looters on sight and to ban high-ranking Baath Party members from office. In the circumstances, this may count as a sort of improvement.

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Iraq's Shias

Return of the exile

May 15th 2003 | NAJAF
From The Economist print edition

An Islamic government, or influence from behind the scenes?

Get article background

IT WAS billed as an historic return. On May 12th, Muhammad Baqer al-Hakim, a “grand ayatollah” and the scion of a clerical dynasty that has given 23 lives to the struggle against Saddam Hussein, came home from exile to Iraq's shrine city of Najaf. Backed by Iran, where he has lived for more than two decades, and warily accepted by the Americans, who have invited him to help form an interim Iraqi government, he may have been hoping that devout Shias would flock to his side. So far, they have not.

Reuters

Some were glad to see him

Since he crossed the border on May 9th, Mr Hakim has received pledges of support from several tribal sheikhs. The bunting along his route was impressive. But unkind comparisons are being made with the return of an earlier Shia visionary: when Ayatollah Ruhollah Khomeini came home to Iran in 1979 to set up an Islamic theocracy, millions greeted him. When Mr Hakim entered Najaf, the Vatican City of Shia Islam, he attracted only 15,000.

The seminary at Najaf, which lost thousands of students and teachers to Saddam's executioners and prisons, views Mr Hakim with scepticism. His lofty designation, seminarians whisper, is self-conferred, and many suspect Iran of stage-managing his showy return—even down to his besuited (and unshaven) bodyguards. His opponents recall the two failed Shia revolts in the 1990s, when, they say, his Iran-backed army delivered much less help to the rebels than had been promised.

The empty drum makes the loudest noise, sniffs Muhammad al-Haqqani, an associate of Ayatollah Ali Sistani, who is the most senior of Najaf's four uncontested grand ayatollahs, and the most influential proponent of political abstinence for the clergy. Among the opposite-minded clerics, who look to an Islamic government dominated by the seminary, Mr Hakim's main competitor is Moqtada al-Sadr, a young and theologically junior member of an important clerical family.

The late Muhammad Sadiq al-Sadr, one of several senior ayatollahs whom Saddam Hussein arranged to be killed, agreed substantially with Khomeini on the necessity of clerical rule. Moqtada al-Sadr apparently shares that view; he is also reputed to be a hothead. Shortly after the Americans took control of Najaf last month—wisely confining themselves to the outskirts of the city—he was said (though he strenuously denies it) to be implicated in the murder of Abdul Majid al-Khoei, the British-backed son of yet another great clerical family.

Mr Sistani and his supporters observe what is going on with distaste, calling for calm and trying to engineer unity and moderation behind the scenes. Mr Sistani, a *marja*, or spiritual reference, is the ultimate authority, but he refuses to join the babble of clerical voices demanding influence over the government. His political quietism has historically dominated the seminary, and he and his followers probably expect this to resume.

Will it? Such is the extent of Saddam Hussein's demolition job—in the past three decades, the number of clerics in Najaf is thought to have dropped from about 7,000 to fewer than 1,750—that it is hard to predict how the seminary will reconstitute itself. The return of hundreds of exiled clerics will have an effect, but not necessarily in favour of theocracy: those who spent years in Iran may have misgivings about using the Islamic Republic as a model.

However, many Iraqi Shias, having chafed at centuries of political subservience to the Sunni minority, now excitedly identify an opportunity to impose their will. They are not prepared to do so through secular co-religionists, such as Ahmed Chalabi, who enjoys American backing but virtually no support in the Shia heartland. Many of the people who greeted Mr Hakim when he entered Najaf believe that Iraq's next government should be an Islamic one, though they have sketchy ideas about what that means.

Iran's shadow is long. The prestige now enjoyed by Iraq's depleted clergy recalls Iran after the 1979 revolution. But that prestige has been eroded by 24 years of Iranian theocracy. If he is not careful, Mr Hakim could end up being likened to Ayatollah Ali Khamenei, Iran's supreme leader, who styles himself a grand ayatollah to the derision of his peers, and who presides over a crumbling Islamic Republic.

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Basra's misfortunes

Free for all

May 15th 2003 | BASRA
From The Economist print edition

Confusion, fear and rumour in Iraq's second largest city

Get article background

AP

At another mass-grave

EVERY household in Basra has two or three guns, remarks a witness to the daylight murder of two Christian liquor-dealers. A water-pumping station is stripped of its equipment while it is being repaired by UN technicians. Young men amuse themselves with car-jacking and violent robbery. The 1.25m, mostly law-abiding, inhabitants of Iraq's second city do not lament the fall of Saddam Hussein, but they do regret the passing of a time when the streets were safe.

The British, who took Basra on April 4th, are ill-equipped and disinclined to fill the gap left by the 16,000 police who used to keep order in the city and the surrounding countryside. Until last Saturday, metropolitan Basra was being policed by 48 armed British military policemen, plus 900 unarmed locals: they were detaining just four or five miscreants daily. On May 10th, some 500 more Iraqi policemen joined the force, and more will follow, but it will be months before they are trained.

“We have removed the reasons for people's fear,” claims a senior British official, “but not their fear.” The prime anxiety is that the occupiers will depart too soon, leaving chaos in their wake. Having been horrendously repressed for rebelling in 1991, Iraq's Shias—the overwhelming majority in Basra—are susceptible to rumours of a Baathist come-back. Appalling evidence of their earlier treatment is coming to light with the excavation of mass-graves outside the city; another such grave, found south of Baghdad, contains thousands of corpses whose mouldering identity papers show they came from Basra.

At the same time, there is a dread of Balkanisation. Shia intolerance was kept under tight control by the Baath regime, but now bare-headed women are harassed in the street, while broadcasts from the Shia theocracy in Iran denounce the British. One doctor claims that the would-be looters of medicines from his hospital wore the black clothes and neat beards that are associated with the Supreme Council for Islamic Revolution in Iraq (SCIRI), which is beholden to the Iranians.

The British profess benign indifference to local politics; the advisory council they have convened, composed of tribal sheikhs, professionals and a handful of religious leaders, is supposedly “apolitical”. Sheikh Mazahem al-Tamimi, the council leader, gets little thanks for helping to restore services such as water and electricity. He clearly regrets having to take orders from the occupiers, who kicked one of his nominees off the council for alleged corruption, and is beset by charges of leniency towards former Baathists.

Mr Tamimi says he wants to see immediate elections for provincial governor, but few people outside his own, eponymous tribe would be likely to vote for him. Nor are people perceptibly gravitating towards the myriad political parties, old and new, that have laid claim to state-owned buildings. The SCIRI is perhaps the biggest, though it is tainted by its association with Iran, which killed many tens of thousands of Iraqi Shias during the 1980s war.

Few in Basra know much about the people that the Americans have proposed as the “nucleus” of an interim national administration. Both Mr Tamimi and his British masters agree that, with some exceptions, these nominees do not represent many Iraqis. Locals accept the material help, and the moral

leadership, being offered by some 200 rejuvenated mosques and Shia community centres, but it is too early, they say, to think about politics.

This is partly because of the political lobotomy performed on them by Saddam Hussein, partly because life remains so uncertain. Some 6,000 workers, plus their families, are out of work because the British occupiers failed to prevent looters and saboteurs from gutting two big factories. Dealers in the bazaar refuse to accept bank notes that are rumoured to have been stolen, and opportunists are buying them up at a discount. “It's time for the military to start withdrawing,” says the senior British official. Who will take their place?

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Kirkuk's fortunes

Success story

May 15th 2003 | KIRKUK
From The Economist print edition

All going remarkably well, though troublemakers are on the prowl

Reuters

Wages, at last

Get article background

NOT the most attractive city in northern Iraq, Kirkuk has long been regarded as one of the region's prizes. Its charms, of course, are greatly enhanced by its proximity to Iraq's second-largest oilfields. But it is also the spiritual home of the country's Kurdish and Turkomen people, and counts Arabs and Assyrian Christians among its 750,000 or so residents. Although the combination of past injustices and present uncertainties makes the city ripe for internal unrest and external interference, many believe that the diversity of Kirkuk could make it a model of coexistence.

And so far, at least, Kirkuk can be counted as something of an American success. Despite intensive looting and a few ugly battles over property and land in the days after the city's fall, it is generally stable and secure. A multi-ethnic police force patrols the streets alongside American troops, and the carrying of guns in public has been forbidden.

There is clean drinking water, tolerably constant electricity and telephones, and plenty of food. Oil began to flow this month and the 9,000 workers of the North Oil Company received their overdue wages after American soldiers drilled a hole in the roof of a bank vault, retrieving around half a million dollars' worth of Iraqi dinars. The city's teachers have got their pay-packets, and health-care workers are said to be next.

Bruce Moore, the retired general who heads the northern branch of the Office for Reconstruction and Humanitarian Assistance, says that progress in Kirkuk has been achieved with remarkably few American soldiers—just 2,500 members of the 173rd Airborne Brigade, which took control after the city's liberation by Kurdish guerrillas and American special forces.

The city is technically under martial law, but a very nuanced version of it. Most of the 173rd is based at the airfield, but the brigade's commander, Colonel Bill Mayville, has set up an operations centre in the former governor's building. There he makes himself accessible. He supervises a community council which meets twice a week, and, rather in the manner of a Kurdish *agha* in his *diwan* (tribal court), receives a stream of daily visitors, who come to ask for assistance or to press a case.

Colonel Mayville, a 43-year-old West Point graduate, insists this is no time to relax. Sensitive issues lie

ahead. Reversing the effects of Saddam Hussein's Arabisation programme, which displaced at least 100,000 Kurds from their homes, is one. Another is coping with the crimes of Saddam's regime: a new mass-grave seems to be discovered weekly in the green fields around Kirkuk.

The colonel refers darkly to interference from the outside, meaning the Turkish special forces and the Iranian intelligence agents who are believed to be working under cover inside Kirkuk. The city belongs to its people, he says, and it is to them that America will eventually hand it over.

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George Bush and the social conservatives

A troubled marriage

May 15th 2003 | WASHINGTON, DC
From The Economist print edition

A conservative president has more problems with one section of his party's right-wing than you might think

Get article background

GEORGE BUSH's relationship with his business supporters could hardly be more straightforward. Business people give him huge piles of money. In return he cuts their taxes and shreds red tape. But there is nothing straightforward about his dealings with another big part of the Republican Party: its social conservatives.

Mr Bush's relationship with these voters is like a troubled marriage: tantrums and tearful apologies, long sulks and periodic fireworks, trial separations and loving affirmations that they can't live without each other. Think of Richard Burton's relationship with Elizabeth Taylor (without the jewellery) and you get the idea.

Social conservatives have two defining issues: “life” (which has to be protected from abortion) and “marriage” (from homosexuals). They are now terrified that the Republican establishment is preparing to sell them down the river on marriage, all because of Mr Bush's need to lure in moderate voters. Earlier this month, leading social conservatives met the party's chairman, Mark Racicot, to make their unhappiness clear. They extracted a promise from him to meet with a group of “reformed” ex-gays.

The current furore was provoked by Rick Santorum, the third-ranking Republican in the Senate. Last month he linked gay sex to bigamy, polygamy, incest and adultery, asserted that sodomy was “antithetical” to a healthy family and declared: “I have no problem with homosexuality. I have a problem with homosexual acts.”

Mr Santorum got a predictable roasting in what conservatives call the liberal media. In fact his remarks merely reflect Republican orthodoxy: the party platform, for example, goes out of its way to define marriage in a way that rules out gay unions. Yet Mr Bush's people hardly rushed to defend their senator. Phyllis Schlafly, who brought down the Equal Rights Amendment in the 1970s, describes the establishment's defence as “limp”. Paul Weyrich, head of the Free Congress Foundation, characterises it as “tepid”.

For social conservatives this is just the latest in a long series of attempts by Mr Bush's advisers to make his party more “gay-friendly”. At the 2000 convention there was a minor purge of anti-homosexual rhetoric; there will be another in 2004. Mr Bush has appointed several openly gay people to his administration, including an ambassador and two successive heads of the Office of National AIDS Policy. Social conservatives are particularly angry about a secret meeting in March between Mr Racicot and Human Rights Campaign, a gay lobbying group.

Gary Bauer, a one-time presidential candidate, thunders that the “grass-roots will not stand for continued ambivalence on these moral issues.” His successor as head of the Family Research Council, Kenneth Connor, says “a house divided against itself cannot stand.” The Rev Don Wildmon, who owns nearly 200 radio stations, declares that, if the Republicans continue to beam at gays, “we will walk”.

Gay marriage is not the only “betrayal”. Mr Bush has been far more willing to spend his political capital on tax cuts than on faith-based initiatives (which have been allowed to wither on the vine). Many fundamentalists dislike his insistence that Islam is a peaceful religion. Some are even angry that John Ashcroft, their main man in the cabinet, has taken such a draconian line on civil liberties: they worry that a future attorney-general may be able to spy on conservative religious organisations.

Does all this noise matter? Some of the smartest observers of the political scene doubt it. Norm Ornstein, of the American Enterprise Institute, calls it a “toothless bark”. Would social conservatives really be willing to hand the White House over to the pro-abortion, pro-gay Democrats?

Besides, most social conservatives still like Mr Bush. He enjoys approval ratings of more than 95% among Republicans; he also enjoys something that his father never had: trust. Mr Weyrich, the man who invented the “moral majority”, thinks that Mr Bush's record on social issues is even better than the sainted Ronald Reagan's. This trust is there largely because Mr Bush has fought harder on the other big social issue, abortion.

One of Mr Bush's first acts as president was to cut off money for organisations providing abortions overseas. He has supported several measures to restrict abortion rights, ban partial-birth abortion and define human fetuses as children (with attendant government-provided health benefits). He has imposed restrictions on stem-cell research and he used religious language in calling for a ban on cloning (“Life is a creation, not a commodity”). And he has bullied the Department of Health and Human Services into promoting sexual abstinence and marriage.

Mr Bush has done other righteous things. His judicial nominations have included several evangelical Christians, such as Charles Pickering and Claude Allen, a leading advocate of abstinence-education. He has done all he can to accommodate conservative worries about his $15 billion initiative to fight AIDS in the developing world. A third of the money will be spent on abstinence-education. Religious groups that participate in the scheme will not have to promote anything they see as morally objectionable.

The threat of staying at home

Yet there are still three good reasons to think that the barking from the right may not be entirely toothless. To begin with, social conservatives are not as pragmatic as the deal-doing business conservatives are. They are absolutists, who are willing to go to the stake for certain issues.

Second, social conservatives are now buried deeper inside the Republican establishment than ever before. In the 1990s conservative Christians tended to work through outside organisations such as the Christian Coalition. More recently they have worked from within, taking the battle to precinct meetings and the like. According to a study in *Campaigns and Elections*, a Washington magazine, Christian conservatives now exercise either “strong” or “moderate” influence in 44 Republican state committees, compared with 31 committees in 1994, the last time the survey was conducted. They are weak in only six states, all in the north-east. Ralph Reed, the Christian Coalition leader until 1997, now runs the Georgia Republican Party.

Anyone who doubts the clout of these Christian conservatives within the party should study the fate of last year's bankruptcy-reform legislation, which the business wing of the party wanted. Social conservatives destroyed the bill because it included a provision designed to crack down on anti-abortion protesters.

A third reason for Mr Bush to worry about social conservatives is that they do have an alternative to

voting Republican: they can stay at home. Karl Rove points out that some 4m Christian conservatives who voted in 1994 failed to vote in 2000. The return of many of these voters to the fold in 2002 helped the Republicans pick up vital Senate seats in Georgia and Missouri. If they feel let down in 2004, it could hand a close election to the Democrats.

It will not get any easier. The White House's strategy for the next year is to focus on conservative causes that have overwhelming public support—such as opposition to cloning and late-term abortion. But it will also have to deal with several issues that could drive a wedge between conservative activists and swing voters.

The most important decision will involve the Supreme Court. At least one Supreme Court justice may retire in the next year or so. Conservatives see the selection of a new justice as an issue on which they are prepared to break with the president. “We will not put up with another [David] Souter,” says Ms Schlafly, referring to a judge appointed by George Bush senior who has since voted in a liberal manner. On the other hand, moderate suburban women would be horrified by the idea of another conservative in the court, particularly an anti-abortion one.

Sexual politics will also crop up in two other decisions. The Massachusetts Supreme Court will decide (in the Goodridge case) whether to legalise same-sex marriage. The federal Supreme Court will decide (in the Lawrence case) whether to overturn a Texas law that criminalises sodomy between same-sex couples. Social conservatives and moderates will want to know Mr Bush's opinion.

Mr Bush is better placed than anybody else in his party to manage the religious right. But some spouses are not amenable to even the most enlightened management. The Republican Party currently looks like an extraordinary electoral machine. But it would be foolish to forget that the party is an amalgam of lots of different groups—and that one of the most important of these groups, the social conservatives, has a mind and a will of its own.

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The great Texas Democrat hunt

Band on the run

May 15th 2003 | AUSTIN
From The Economist print edition

First rule of politics: if you're going to lose, run away

Get article background

AP

Lining up the outlaws

THE party that sent Lyndon Baines Johnson to the White House and ruled Texas for more than a century has had its share of indignities in recent years. Today, the once all-powerful Democrats hold no state office of any consequence. This week they played the only card they had left: they ran away—with the police in hot pursuit—thus depriving the Republicans of the quorum of 100 lawmakers they need to pass laws in the 150-strong state House. In all, more than 50 Democrats—"Killer Ds" to their supporters, "Chicken Ds'' to the Republicans—slipped across the Red River into Oklahoma. Most have holed up at a Holiday Inn in Ardmore, out of reach of Texan justice.

As *The Economist* went to press, it looked as if they were going to stay there past May 15th. Only bills that have already passed the state House by that date can become laws. That means tort reform will get through, but not a bill authorising a power grab by the Republican House majority leader in Washington, DC, Tom DeLay. This former pest-exterminator, known as "the Hammer", had convinced Republicans in his home state to push a redistricting bill through the Texas legislature which would add five or so Republican seats in the Congress.

From their hole in the wall in Ardmore, the Democrats, who were no mean redistricters themselves in the good old days, claim their flight was made unavoidable by "Mr DeLay's ego, appetite for power and disregard for our constitutional rights". A furious Mr DeLay suggested that the FBI arrest them. To no avail. The Republicans have got the famed Texas Rangers conducting a statewide dragnet, and they also sent four plain-clothes troopers, a bus and a jet to Ardmore in the hope of convincing enough Democrats to make the magic 100 votes. None came.

Besides killing off the redistricting, the Democrats' boycott will also spoil the plan to plug the state's $10 billion deficit. This is not making them popular, even in their Oklahoma bolt-hole. A sign in Ardmore reads, "Chickens are popular—in France.'' Against this, the "Killer Ds" do not think they have much to lose. They hate the slash-em-up Republican budget, anyway; and they have been chafing against the iron-fisted rule of Tom Craddick, their new House speaker.

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Race and prosperity

The past delays the future

May 15th 2003 | GREENVILLE, SOUTH CAROLINA
From The Economist print edition

Will quarrels over history stop people investing in South Carolina?

Get article background

A LOT of tyres roll out of Michelin's huge factory in Greenville. Lockheed Martin and General Electric are also busily at work in this South Carolina county; so are numerous textile companies and a growing number of firms based in Europe and Japan, not to mention 500 locally owned small businesses. Greenville county has long been South Carolina's chief centre of industrial growth. So the protest march the Rev Jesse Jackson has planned for May 17th, and an economic boycott of the county that began in late April, are a worry to many people.

Why is Mr Jackson, who was raised in Greenville, so angry with it? Because the county council refuses to make the birthday of the murdered civil-rights leader, Martin Luther King, an official paid holiday for county workers. Mr Jackson, an eloquently radical black politician, was with King when he was assassinated in 1968. “I am personally hurt that my home community won't honour that man,” Mr Jackson says.

The county council is a bit of an oddity. King's birthday has been a federal holiday since 1986, and a South Carolina state holiday since 2000. The city of Greenville joins in willingly enough. But the county council, which has a white majority, has for years declined to name the third Monday in January as a paid holiday—one of only three South Carolina counties that still hold out. The refusers say it is too costly to give the county's 1,600 employees another paid holiday, especially in the current recession.

Congressman Jim DeMint, a conservative white Republican who supports a paid King holiday, thinks the problem could be solved if “outside agitators” like Mr Jackson would go away. But Mr Jackson won't. He has got Kweisi Mfume, the president of the National Association for the Advancement of Coloured People (NAACP), to join in Saturday's march, which takes place on the 49th anniversary of *Brown v Board of Education*, the Supreme Court decision that ended segregation in America's public schools.

It is not only in Greenville itself that people are worried. The quarrel there, it is claimed, could affect other parts of the state. Next-door Spartanburg county is the home of the only factory in North America of the German carmaker BMW. Maybe other companies, American and foreign, that are thinking of moving to South Carolina will be scared off. Racial wrangling can cause much embarrassment.

And it isn't South Carolina's only such wrangle. Passions about the Civil War have not yet entirely vanished. For the past two years the state's section of the NAACP has been urging Americans who oppose the flying of the Confederate battle flag not to spend any money in South Carolina. Its complaint is that, although the state's lawmakers voted in 2000 to take down the Confederate flag that had flown for decades over the State House, they declined to send it off into a museum. They plonked the flag down on the State House lawn, facing a busy intersection, where it still flutters rebelliously.

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Minnesota's budget

Miracle. On ice

May 15th 2003 | ST PAUL
From The Economist print edition

He'd rather be playing hockey, but Tim Pawlenty has a deficit to sort out

AP

On thin ice?

COLD, northern and Lutheran, with ice-fishing and coffee-klatches apparently the pinnacle of its social life, Minnesota does not always seem the most desirable place to live. But, over the decades, the collectivist impulse inherited from Scandinavia has been credited with making this state a particularly humane and even prosperous place. That impulse was encapsulated in a package of new policies passed by the legislature in 1971: a “Minnesota Miracle” that increased state funding for education and municipal services, raised income and other taxes, and lowered taxes on property.

Three decades later, the major components of the miracle are still there. All that time, Minnesota has consistently ranked among the top states in health care, education, quality of life—and burden of taxes. But a two-year $4.2-billion budget deficit is now threatening the state's Scandinavian tendencies. Its Republican governor, Tim Pawlenty, is brandishing the scythe, arguing that the state spends too generously and taxes too heavily.

Minnesota, like many states, has seen a steep decline in tax revenues coupled with a precipitous rise in health-care costs. On top of that, the state is taking on the full cost of primary and secondary education, thanks to legislation enacted by the previous governor, that unpredictable brawler, Jesse Ventura.

Mr Pawlenty proposes to reduce the deficit without raising taxes or cutting school spending too much. That means deep cuts in state-funded health care, welfare programmes, higher education and aid to local governments, the poorest of which rely on the state for more than half their money. If his cuts become law, tens of thousands of low-income Minnesotans will lose their health insurance, thousands more will lose their welfare benefits, tuition fees at the state's public universities will rise by double-digit margins, and towns across the state will put up property taxes while paring back services.

Trying to sweeten the pill, the governor has criss-crossed Minnesota with a winsome smile. He says that the state faces a “New Frontier” (a phrase borrowed from Jack Kennedy), and exhorts its citizens to transform their collectivist generosity into a spirit of collective sacrifice. Early polls suggested that 56% of Minnesotans supported this approach, especially the no-new-taxes part, and the state House of Representatives also gave its backing.

But more recent polls suggest that Minnesotans are deeply confused about curbing the deficit. Most of them think spending cuts are the answer; but when they start to consider specific cuts in, say, health care, a slim majority prefers to raise taxes. In good populist fashion, almost 80% favour raising taxes on the richest in the state. And 70% support an increase of a dollar a packet in the cigarette tax.

The polls have dug both the big parties deeper into their redoubts. This week, the state Senate voted to raise taxes by $1.3 billion, but both the governor and the House oppose this. There will probably have to be a special session that could last into the summer. It was at the end of such a marathon special session in 1971 that another winsome governor, Wendell Anderson (from Minnesota's Democratic Farmer-Labour version of the Democratic Party) prevailed in the budget battle that produced the Minnesota Miracle. His triumph put his face on the cover of *Time* with the headline “The Good Life in Minnesota”.

Much links the two governors. Both have humble roots; both attended the University of Minnesota, staying on to do law degrees; both faced fiscal crises in their first year as governor. They also share a love of ice-hockey; Mr Pawlenty had a match with Mr Anderson, who played for the United States Olympic team, during the festivities that marked his inauguration. But critics have been quick to note the differences, too. Mr Pawlenty pledges no new state taxes, Mr Anderson raised them substantially; Mr Anderson lowered local property taxes, Mr Pawlenty's policies will almost certainly force them up again.

This may be just a grim opening act for Mr Pawlenty. If he can solve the budget mess, he may win a breathing space for further reforms. He is a great one for making state government more efficient; many locals admit the Minnesota Miracle has made budgeting too haphazard. But it may take time for Minnesota to decide to relinquish the dream of becoming another Sweden.

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The latest spy story

They let her clean the China

May 15th 2003 | LOS ANGELES
From The Economist print edition

Meet the “Parlour Maid”, accused of being a latter-day Mata Hari

AP

Two flags, two masters?

Get article background

THE last thing the FBI wants is more public scrutiny. It failed to spot things that might have given warning of the terrorist attacks of September 2001. It suffered the embarrassment of having one of its agents, Robert Hanssen, caught exchanging state secrets for Russian diamonds. Now it has another scandal on its hands.

Katrina Leung, who pleaded not guilty to various spying charges in a Los Angeles federal court on May 12th, does not sound like your typical double agent. A prominent local businesswoman, she sat on a distinguished foreign-policy committee with Disney's chairman, Michael Eisner, and a former secretary of state, Warren Christopher. She prided herself on her contacts in both the American and the Chinese governments. In 1998, when a former Los Angeles mayor, Richard Riordan, wanted China to sign a multi-million-dollar contract for the use of Los Angeles's port, Ms Leung is said to have fixed a meeting with the Chinese president, Jiang Zemin. The trouble is that the woman the FBI code-named “Parlour Maid” may have been handing over American secrets to China's Ministry of State Security.

Her FBI “handler” seems to have been a bit of a mishandler. In 1982 James Smith hired Ms Leung, then a 28-year-old immigrant from China, to do counter-intelligence work. She seemed well-qualified. She was fluent in Mandarin, Cantonese and English. She had a degree from the University of Chicago. But, although both of them were married, it was alleged this week that Mr Smith and Ms Leung plunged into a sexual affair that lasted nearly two decades. During this time, say documents produced in court, Mr Smith negligently let Ms Leung take classified documents out of his briefcase (sometimes while he was using the bathroom).

After searching her house, FBI investigators claim to have found three sets of photocopies, all containing classified information. One related to an FBI investigation of Peter Lee, a scientist convicted in 1998 of providing the Chinese with information that may have helped them develop their nuclear programme. The second was an intercepted conversation between two Chinese agents, “Luo” and “Mao”, discussing “issues relevant to national security”. The third was described as a secret FBI electronic communication.

Another FBI agent, William Cleveland, is also alleged to have had a sexual relationship with Ms Leung.

The FBI came to suspect that she was a double agent in 1991, when Mr Cleveland identified the voice of “Luo” as hers. He at once told Mr Smith of this, but her handler apparently took no notice; according to the indictment, he subsequently made 19 reports to his FBI superiors saying that Ms Leung was a reliable source (which he believed, say his lawyers, even though she refused to take a polygraph test). At no time did either man know that Ms Leung was having an affair with the other.

In 1997, during an investigation into political donations from a wealthy Indonesian businessman, Ted Sioeng, Ms Leung said he was a respectable member of the local community. Federal investigators believed that in fact Mr Sioeng was working for China, and sought to influence American politics by giving $250,000 to the Democratic National Committee. Ms Leung is quoted as saying of Mr Sioeng: “If there is one criticism I can make of him, it is that he got himself in the limelight for so long that he attracted rumours and speculation.” A comment the Parlour Maid might usefully have applied to herself.

Ms Leung faces up to 50 years in prison if convicted on all charges; Mr Smith, who has also pleaded not guilty, could get up to 40. The government has said, in court documents, that “the FBI must now reassess all of its actions and intelligence” about Ms Leung. The bureau has declared that “counter-intelligence and counter-terrorism are top priorities, and human sources are the backbone.” Mr Smith and Mr Cleveland are presumably glaring furiously at each other.

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Lexington

The vanishing lobby

May 15th 2003
From The Economist print edition

The bombs in Riyadh will further undermine Saudi Arabia's influence in Washington

Get article background

ASKED to name the most powerful foreign lobby in America, most people would say Israel's. But for years another country has been almost as successful in protecting its interests: Saudi Arabia. Now the Saudi lobby is facing its biggest crisis. The story of the decline of Saudi influence in Washington reflects not only the decay of a strategic partnership but also the problems inherent in conducting diplomacy through personal ties.

For all the conspiracy theories about Jewish cabals in the Bush administration, the Israeli lobby is largely a “bottom-up” affair: its power comes from being able to mobilise Jewish voters and fund-raisers, as well as from widespread sympathy for Israel among non-Jews. The Saudis have run a “top-down” operation. There are few Saudi-Americans to be mobilised. The Saudi clout comes from influence on a handful of important people.

This is exemplified in the story of Saudi Arabia's ambassador to Washington, Prince Bandar bin Sultan. The swashbuckling prince is Exhibit A for the theory that gregarious charm and social success pay diplomatic dividends. Exuberant and cigar-smoking, he peppers his idiomatic English with references to Thomas Jefferson and American football (he supports the Dallas Cowboys), and serves hamburgers on silver platters. His former job—as chief acrobatic pilot for the Saudi air force—was helpful in negotiating the sale of 60 F-15 fighters to Saudi Arabia, the first big American arms sale to an Arab state.

Prince Bandar is a throwback to the days when diplomats did not just communicate policy, they shaped it according to whom they knew. He was go-between for the Clinton administration when it was dealing with President Hafez Assad of Syria and the Palestinians' Yasser Arafat. He persuaded Libya's Muammar Qaddafi to hand over the perpetrators of the Lockerbie bombing. Last August he became one of only four foreigners—the others were all heads of government—to be invited to lunch at President Bush's Texas ranch. The photograph was splashed over the Saudi papers to show the kingdom's clout.

Yet in reality Prince Bandar's power—like that of his country—has long been waning. His glory days date back to the first Gulf war, when he virtually lived in the White House, was treated as a member of the Bush family (he wrote to the former president, “You are my friend for life, one of my family”) and helped

to save his country from Saddam Hussein. But, if you live by personal connections, you die by them. Prince Bandar found the Clinton White House less welcoming. His relationship with Sandy Berger, the national security adviser, was especially frosty. He hoped—like many other Arab leaders—that the election of the younger George Bush would bring back the old days.

But by then he was starting to lose influence at home as well. Prince Bandar is the son of the Saudi defence minister, Prince Sultan. He was close to his uncle, King Fahd. One foreign leader told the *New Yorker* recently that the prince's power lay in knowing the king's real views when these differed from the official Saudi position. But now a frail King Fahd has handed over day-to-day control to Crown Prince Abdullah, who has never been close to Sultan or Bandar.

These murky family quarrels were soon made worse when the second President Bush refused to do what the new Saudi heir-apparent most wanted—apply his thumb to Israel, and put more effort into Middle East peacemaking. In the summer of 2001 Crown Prince Abdullah ordered Prince Bandar to deliver a startling message: the Saudi government was prepared for a fundamental reappraisal of its ties with America. If the aim was to apply shock and awe to the administration, it worked. “What the fuck are you doing?” the *New Yorker* reported Colin Powell as saying. “You scared the shit out of everybody.” “I don't give a damn,” the prince is said to have replied to his former squash partner. “We're scared ourselves.”

In a letter to the crown prince, Mr Bush duly reassured the Saudis of American friendship and, for the first time, backed the creation of a Palestinian state. But the diplomatic costs were huge. The episode undercut Prince Bandar and the personal connections on which his country's influence depended in Washington. Since then, the prince seems to have spent most of his time in Aspen, Riyadh or England.

A kingdom under siege

And the timing—just before September 11th—was as bad as it could be. When 15 of the 19 hijackers turned out to be Saudi citizens, there was no one to go on television to say that al-Qaeda threatens Saudi Arabia as much as America. No one went to Capitol Hill to soothe congressmen irate that the Saudis are (as Senator Joe Biden put it) “funding hatred”. When a charitable donation from Prince Bandar's wife went astray and ended up with al-Qaeda, it seemed to confirm American suspicions.

This week the Saudis have tried to use the Riyadh bombing to rebuild the relationship, pointing out that Saudi Arabia, like America, is a victim of terrorism. The Israelis made a similar connection with suicide bombings. But this time the American public is likely to conclude that the Saudis are incapable of dealing with terrorists in their own land. And influential neo-conservatives, who think the Saudi royal family is part of the problem, not the solution, will hardly be reassured.

None of this means that the basic bargain between the two sides—American protection for Saudi oil—has collapsed. The recent decision to pull most American troops out of the kingdom will remove one source of friction inside Saudi Arabia itself. Links between the two countries' intelligence services remain, by all accounts, excellent. But there is more to alliances than this. In terms of public diplomacy, the old methods by which Saudi Arabia wielded so much influence in Washington are gone. So far, nothing else has taken their place.

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Argentina's election

Don't cry for Menem

May 15th 2003 | BUENOS AIRES
From The Economist print edition

AFP

It's Néstor Kirchner, Argentina's new president, who has grounds for complaint

Get article background

OVER his wildly fluctuating career, including a decade as president and many a scandal and probe, Carlos Menem has done his country some services and many disservices. This week, he did it the biggest disservice of all. By pulling out of Sunday's run-off ballot, he has not just run away from the judgment of the voters. He has done his best to deny Néstor Kirchner, Argentina's new president, the popular mandate he so desperately needs if he is to complete his country's recovery from its horrendous financial collapse of 2001-02.

Opinion polls show that Mr Kirchner, a fellow Peronist and hitherto obscure provincial governor, would have won around 70% of the vote on Sunday to Mr Menem's 30%. Now that vote will not take place. Mr Kirchner will take office on May 25th, but the official result of Argentina's 2003 presidential election will be the narrow victory registered by Mr Menem in its first round. When things get tough for Mr Kirchner, as they surely will, Mr Menem will no doubt use this to dispute his legitimacy, and to cause trouble.

For Mr Menem, the collapse was surprisingly swift and artless. After months predicting an easy victory, he won the first round on April 27th with just 24% of the valid votes—a mere 2% ahead of Mr Kirchner. He never appeared to recover from the shock. Despite his reputation as a political fox, his magic, at 72, was clearly waning, and the decline in his support caused panic among his regional backers, mainly governors and mayors, who are themselves running for re-election later this year. He tried to claim that the election process was tainted. But in truth most Argentines were unwilling to forgive him for the corruption that marked his government, or for sowing the seeds of the country's economic collapse.

Mr Menem joins a long and inglorious recent list of Argentine leaders who have fled their political responsibility. He himself assumed office six months early in 1989, after the resignation of his predecessor, Raúl Alfonsín. His successor, Fernando de la Rúa, abandoned office in December 2001 after two years, to be replaced by Adolfo Rodríguez Saá, who lasted just a week. The current president, Eduardo Duhalde—Mr Kirchner's sponsor, and Mr Menem's arch-enemy—also brought forward his departure after social unrest last year.

So, after all this, Mr Kirchner will be in office. But will he be in power? He can take heart from Argentines' rejection of the old guard, personified by Mr Menem. But he will have to earn his mandate by effective government, and that starts with the economy. He is more than likely to make Roberto Lavagna, Mr Duhalde's economy minister, his finance minister. That would be a good start, as Mr Lavagna has done much to repair Argentina's finances thus far.

With a short-term IMF deal due to lapse in August, a new accord will be conditional on a restructuring of the shattered financial system and a long-delayed and politically unpopular hike in utility tariffs. Mr Lavagna has indicated that he is ready to grasp that nettle. The Fund is also pressing for talks to start on the restructuring of Argentina's debt, the servicing of which will probably mean doubling the current primary fiscal surplus from around 2% to 4% of GDP. All this while trying to nurture the incipient economic revival and improve social conditions; over half the population is below the official poverty line.

The political agenda is no less demanding. Mr Kirchner is less popular than Mr Menem within his own Peronist movement, and owed much of his success in the first round to the backing of Mr Duhalde's party machine in Buenos Aires province. Many Argentines still see him as a mere puppet in Mr Duhalde's internecine battle against the former president.

But Graciela Römer, a political analyst, reckons that Argentina's new president has demonstrated at least some early signs of adapting to an emerging political culture based on pacts and alliances, eschewing traditional demagogy. Mr Kirchner appears to understand the new environment, she says. “We will have to wait and see his first acts of government to get a clearer idea...But his success so far has been due to achieving at least some across-the-board support, based on stronger political institutions rather than personal leadership.” Thanks to Mr Menem's poisoned chalice, he now has no choice but to try to govern that way.

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Guatemala

A country turns upside down

May 15th 2003 | GUATEMALA CITY
From The Economist print edition

Guatemala is getting more like Colombia every day

AP

Still good breeding ground for civil unrest

Get article background

THE travelling circus that is the Central American Free-Trade Agreement (CAFTA) came to Guatemala City this week, hoping to tie up a regional trade pact with the United States by the end of the year. As Central America's biggest economy and its most populous country, with 12m people, Guatemala is the key to CAFTA's success.

However, CAFTA was not the only show in town. The Consultative Group (CG) was there too, checking up on things. The CG is made up of donor countries and international organisations that have underwritten Guatemala's 1996 peace accords. Those accords were supposed to end a civil war that had raged for 36 years and cost the lives of about 200,000 people. But the CG has been given evidence not only that the peace process has stalled, but that the country is slipping backwards.

Elements in the armed forces and police still seem to operate largely outside the law. Last week, a former colonel and head of the notorious presidential guard unit (EMP), Juan Valencia Osorio, was freed on appeal after being convicted last year of ordering the murder of a human-rights investigator, Myrna Mack, in 1990. No one has yet served time for the 1998 killing of Bishop Juan Gerardi. Some judges and lawyers have fled the country and its climate of intimidation; many of the rest are under armed guard.

The peace accords also contained ambitious plans to improve the social and economic conditions which had allowed guerrilla wars to breed. Aid has poured in, but progress has been slight. Even by Latin American standards, Guatemala remains a country of enormous inequalities. The American government estimates that about 83% of the population, and 90% of its indigenous people, live in poverty.

Meanwhile, an ever-closer union is developing between organised crime, former and serving military and police officers and some government officials. No one knows to what extent the security apparatus of President Alfonso Portillo's government is a prisoner of these “parallel powers” (or “clandestine groups”), or in collusion with them. But in January, the United States felt compelled to resuscitate the dead process of “decertification”, arguing that Guatemala was doing too little about drug production or trafficking.

According to the American report, Guatemalan police “stole twice the quantity of drugs that they officially seized and...were identified with drug-related extra-judicial executions of both narco-traffickers and civilians.” One local academic, Glenn David Cox, refers to this as the “Colombianisation of Guatemala”.

The government wavers between co-operation and defiance. On the one hand, it is working with a new United Nations commission to investigate the existence of the “clandestine groups”. On the other hand, Mr Portillo dismissed last week's damning UN report on the implementation of the peace accords with the remark that, if it were all true, “the country would be turned upside down.”

Guatemala's increasingly ugly reputation is already proving costly. The government has failed to sell any of a $500m bond issue in the world markets, after vigorous protests as to what the money might be used for. And American diplomats have given warning that the United States Congress is unlikely to ratify CAFTA if the drugs and human-rights scene in Guatemala remains as it is.

In November, Guatemala holds a general election; the campaign officially opened this week. What should offer hope, though, may precipitate a crisis. It all depends on General Efraín Ríos Montt: a 77-year-old who is one of the last *caudillos* in Latin American politics, the leader of the Congress and, in effect, the head of the ruling Guatemalan Republican Front (FRG) party. On May 24th, the FRG is expected to acclaim him as their candidate, despite the fact that many hold him responsible for the massacre of thousands of civilians during “counter-insurgency sweeps” in the jungle when he was military dictator in 1982-83. Although the constitution bars people who took part in military coups from becoming president, few doubt that, if he was chosen as the FRG candidate, he would be allowed to run.

That would make for a damagingly divisive contest. Already, the FRG's strategy to capture the vital rural vote has caused outrage. The government has just handed over the first tranche of a “compensation” package worth $650 to about 250,000 former members of the notorious Civil Defence Patrols. These men were recruited to help the army during the war; according to a church investigation, at least one-fifth of them were involved in massacres and other human-rights abuses. There is no plan to compensate their victims.

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Canadian politics

Martin by a mile?

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For many, the Liberals' leadership contest looks settled already

Get article background

SIX months must still pass before Canada's ruling Liberals, at their party convention in mid-November, get down to choosing a new leader. Nine months will drag by before Jean Chrétien, who announced his retirement last August, at last hands over the standard. But the snail-slow changing of the guard has speeded up sharply with a series of televised debates between the three contenders. These debates are making painfully clear the strained relations between the two main candidates, Paul Martin and John Manley.

Most Canadians believe that Mr Chrétien planned his drawn-out disappearance deliberately to thwart Mr Martin, whom he had fired as finance minister last June and replaced with the younger Mr Manley. Mr Martin had made no secret of his impatience to be prime minister, considering that he had earned it by eliminating Canada's budget deficits and featuring large in the Liberals' victories in three successive elections. Mr Chrétien appeared to hope his rival would fade into obscurity and become too old (he is 64) to win keen support. His father, Paul Martin senior, failed in three leadership bids, losing his last to the youthful Pierre Trudeau in 1968.

Ironically, his dismissal allowed Mr Martin to make countrywide speaking tours and build up not only a formidable phalanx of delegates but also a massive campaign fund. Meanwhile, Mr Manley had the budget and border security to wrestle with, and he and other cabinet ministers were forbidden to raise funds for several months. He eventually declared his candidacy last month, and has the open support of a dozen MPs—besides that of Mitchell Sharp, a 92-year-old former finance minister who remains the prime minister's mentor.

As for Mr Martin, he opened his campaign officially, on May 6th, with more than 100 MPs—including 15 cabinet ministers— crowded around him. He has toughened his criticism of the Chrétien government, accusing it of drifting on important immediate issues: waiting lists in the health-care system, preventive action over SARS and clumsy handling of the United States in the war against Iraq. He has made a priority of healing relations with Washington, and has declared that Canada should not delay in joining the Nuclear Missile Defence (NMD) project.

The televised debates have unleashed the fierce, or possibly desperate, side of Mr Manley, who is usually thought a bit dull. In both debates, he has challenged Mr Martin to disclose all political contributions he has gathered and the names of the contributors. When Mr Martin, who ran a big steamship line before entering politics, said he would follow party rules and disclose his list 30 days before the convention, his rival retorted that the delegates would have been chosen weeks before. On two occasions Mr Manley has accused Mr Martin of “pandering to the United States”—a curious taunt, many think, since he himself is the minister who has dealt closely with American officials over continental security.

They are both, however, in favour of talking with Washington about partnership on missile defence, arguing that Canada is likely to be the “debris zone” for missiles and should be at the table to protect its sovereignty. The Liberal caucus is divided and has not settled on a position, despite lengthy discussions. It has been left to the third leadership contender, Sheila Copps, the heritage minister, to voice strong opposition to NMD in the debates. Yet Ms Copps is given little chance of winning. She has presented herself as a champion of the environment, gays, minorities and women, and has drawn ridicule for suggesting that the national anthem (“true patriot love in all thy sons command”) should be gender-neutral.

Mr Martin has won most applause in the debates. Indeed, he is seen so widely as the runaway winner that an editorial in the *Globe and Mail* on May 10th argued that Mr Chrétien should leave in November instead of February. Its only reservation was that Mr Martin would then want to call an election in the depths of winter, which would hardly be popular with Canadians. An election would allow him to pick a new cabinet team: one in which, he has made it plain, there would be no guarantee of a post for either of his rivals.

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Peru's president

Toledo's own goals

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An opportunity lost to infighting and incompetence

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AP

She's disillusioned, too

THE economy grew by 5.2% last year, faster than any other in Latin America. Growth is continuing at a similar pace this year. Tax revenues are climbing and inflation is muted. Elections for new regional governments went smoothly. Yet Alejandro Toledo is one of the region's least popular presidents, and ever less so. According to Apoyo, a polling company, only 17% of Peruvians approve of their president. What is going wrong?

Mr Toledo, an economist of Andean Indian descent, took office in July 2001 after ten years of increasingly autocratic rule by Alberto Fujimori. Mr Fujimori's flight to Japan in 2000 revealed not just systematic corruption, but an institutional void. His successor offered a new, democratic, start.

Yet part of the difficulty lies with Mr Toledo himself. He has a knack for creating political problems. He has got involved in matters better left to others: he clashed with Congress by vetoing a populist law to slash telephone rates, only to be accused of collusion with the telephone company by negotiating reductions himself.

Some of his actions echo those of Mr Fujimori. Mr Toledo is alleged to have intervened to arrange the handover of two television stations to allies. After it was revealed that aides had swapped dozens of calls with the director of a TV channel, allegedly pressing for favourable coverage, the aides offered contradictory stories, and Mr Toledo's press secretary resigned.

Several of Mr Toledo's recent appointments have been unwise. To strengthen the presence in government of Perú Posible, his weak and amorphous party, he has sacked many of the reforming technocrats he began governing with. Their replacements are undistinguished. The president's lawyer was forced to resign as head of the intelligence service after just three months over reports that he had illegally tapped phones. The government also faces accusations of nepotism.

Officials claim that elements of the old regime are pulling strings to discredit Mr Toledo and halt his anti-corruption drive. Last week, a congressman was expelled from Perú Posible after he had launched a witch-hunt against José Ugaz, the special prosecutor who had spearheaded an investigation into the corruption of Mr Fujimori's regime which saw scores of former generals and officials jailed.

So far, all the political squabbling has not halted the economy's progress. But there are worrying signs. Richard Webb, the central bank head, is being undermined by infighting among the bank's governing board. Pressure for more public spending is mounting. Public-sector workers want higher wages: on May 12th nearly 300,000 state teachers came out on strike. Regional governments want more investment. Coca farmers are demanding subsidies, while rejecting the crop eradication that is the price of American aid.

Sustaining economic growth requires higher private investment and reform, especially of taxes and of the state. With the economy growing, and with private investment improving too (estimated annual growth was 6.3% in the first quarter, up from 4.3% in the fourth quarter of last year), now is the time to press

forward with such reforms. Instead, the government is borrowing abroad to finance a fiscal deficit that remains at close to 2% of GDP. Unless Mr Toledo changes course, he risks frittering away Peru's great opportunity for democratic revival.

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China counts the cost of SARS

How big a dent in the economy?

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EPA

The next few weeks could be crucial in weathering the slowdown

Get article background

TWO months ago, Zhu Rongji, China's outgoing prime minister, was in denial. On March 5th, in his annual address to the country's legislature setting out economic goals for the year, he uttered not a word about a disease that was sweeping across one of the country's most important manufacturing regions and terrifying Hong Kong's businessmen. Luckily, however, he did not set his sights too high.

Mr Zhu set a goal of 7% GDP growth for 2003, down from last year's 8%. This growth rate is both necessary and achievable through hard work, he told the parliament. With SARS (severe acute respiratory syndrome) now reported in 24 out of mainland China's 31 provinces and municipalities and bringing a sledgehammer down upon the country's tourism, transportation and retail sectors, Chinese officials accept that the disease will dent the economy. But many economists believe the 7% target that was once widely regarded as too conservative may actually be close to the mark (insofar as anyone can tell what GDP growth is in a country as creative with statistics as China).

This assumes that SARS is brought under control in China by the end of June. World Health Organisation (WHO) officials say it is still too early to declare that the disease is being tamed in the worst affected area, Beijing. But the numbers look encouraging. After two or three weeks in which the capital was reporting more than 100 new cases a day, for the past few days the number has dropped to double digits. In Guangdong province, the manufacturing heartland of southern China, where total SARS cases soared into the hundreds in February and March, no new cases were reported on Tuesday this week and only a handful a day for the previous few days. Shanghai, the financial capital, remains relatively little affected, with only seven confirmed cases.

Elsewhere in China, the picture is murkier. In Hebei province, which surrounds Beijing, dozens of cases have emerged among migrant labourers returning to their rural homes from the capital. Chinese officials say a major outbreak in the countryside, where medical facilities are inadequate, is their biggest fear. Should SARS remain entrenched in the countryside, it could pose risks for manufacturers who depend on cheap rural labour. One suspected case in a factory could disrupt operations for days.

Jack Perkowski, the head of ASIMCO, which manufactures car parts in nine provinces, says his factories

are taking a lot of steps to keep the disease out. However, so far only a handful of suspected SARS cases has been reported in factories (Motorola's headquarters in Beijing closed for a few days after a member of staff there was infected). And as far as anyone can tell, given the tattered state of health monitoring systems in the countryside, SARS is still mainly occurring in urban areas. Unlike shops, hotels, restaurants and offices in SARS-affected areas, most factories have carried on working as normal. This is good news given that, as noted by Hu Angang, of Tsinghua University in Beijing, manufacturing and construction accounted for 55% of China's GDP growth in the first quarter of the year. The service sector, which has suffered the worst from SARS, accounted for about 40%, he estimates. As our picture suggests, some restaurants and bars are short of customers, but will bounce back with the retail sector if the SARS outbreak soon comes under control.

Fortunately too for China, the economy grew by a vibrant 9.9% from January to March compared with the same period last year. This was the highest first-quarter growth rate in six years, buoyed by surging foreign direct investment (up 56.7%) and exports (up by 33%). Mr Hu believes that without SARS, China could have achieved 9-10% growth this year. He now believes it will be 8-9%. The World Bank has revised its estimate to 7%, down from 7.5% before the SARS outbreak. Half a percent less of growth means a loss of about $6.2 billion.

Exports and foreign investment are not entirely immune. China is beginning to lose orders because buyers and quality-control inspectors from other countries are staying away. Supply chains are sometimes being snarled by delays as truckers stop at roadblocks erected by local citizens to check those passing through for signs of the disease. At Guangzhou's annual trade fair held last month, the value of contracts signed was less than a quarter of last year's $17 billion.

But even in Beijing, as long as SARS is contained within a few weeks the economic impact is unlikely to be catastrophic. Mr Hu estimates that the city's GDP will grow by around 10%, two percentage points down from what he thinks Beijing could have achieved without SARS. Even if this prediction proves optimistic, Beijing's GDP accounts for only about 3% of the national total. The localised nature of the epidemic, with Beijing seemingly far worse affected than the nearby port city of Tianjin, has protected much of China's economy from SARS's side-effects.

What if the assumptions behind these forecasts are wrong? Chinese officials have long believed that a national GDP growth rate of around 7% is the minimum needed to keep urban unemployment from reaching levels that would seriously threaten social stability. Beijing's government is worried that the declining number of SARS cases in the capital is causing citizens to slacken their vigilance. WHO officials talk of putting the SARS genie back in its bottle. But they question the ability of China's dilapidated health-care system to cope.

However, the country has weathered sharp slowdowns before. There is grumbling in Beijing about the government's attempted cover-up of the outbreak. But it has been quick to offer tax breaks to affected businesses. And if GDP growth threatens to plummet, the government could always respond by boosting its spending, a tool it has previously used to keep growth high. Its leaders know that their strength rests on popular support more than on ideology these days.

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Australia

Strange case of the governor-general

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Respect for the office has crashed

AFP

Focus on a distant figure

Get article background

TO MOST Australians, the governor-general is a distant figure performing the ceremonial functions of a head of state. He actually represents the real head of state who remains Queen Elizabeth of Britain under Australia's 1901 constitution. So it was an unprecedented shock that confronted the country on May 8th when Peter Hollingworth, the present governor-general, and a former Anglican church leader, appeared on television from his official residence in Canberra, the capital, to deny a charge that he had raped a woman. Staring at the camera, he declared, " I did not know this woman. I did not rape her. I did not sexually assault her."

The woman, Rosemarie Jarmyn, had brought a court charge alleging that Mr Hollingworth, then a chaplain, raped her at a church function in the mid-1960s. She claimed to have identified him from a photograph taken then; he argued it was mistaken identity. Miss Jarmyn, aged 57, committed suicide two weeks before Mr Hollingworth's public denial. Up to then both their names had been suppressed by the court. Mr Hollingworth asked the court to lift the suppression order against his name after rumours of the case started circulating in Canberra.

If this were not enough, Mr Hollingworth, who is 68, was already the focus of a separate public row following a report by an Anglican church inquiry that strongly criticised his handling of complaints against paedophile priests when he was Anglican archbishop of Brisbane in the 1990s. The report found untenable Mr Hollingworth's decision to allow a known paedophile to keep working in the church. An opinion poll on May 6th reported that 76% of Australians wanted the governor-general to resign or be sacked. Amid pressure from the public and media and among parliamentarians, John Howard, the prime minister, met Mr Hollingworth five days later. It was announced that he would stand aside until the court charge against him had been dealt with. Few expect his return to the post.

The constitutional storm obscured Mr Howard's afterglow from a visit to America and Britain to receive thanks for Australia's small but symbolic military contribution to the war against Iraq. It almost overwhelmed the impact of modest tax cuts that Peter Costello, the treasurer (finance minister), announced on May 13th in the budget for 2003-04. The budget, with a cash surplus of A$2.2 billion ($1.4 billion) and a reduced but still robust growth forecast of 3.25%, could stand as an economic testament to Mr Howard's tenure should he retire before the next election, as he once suggested he might, and hand over to Mr Costello.

But the governor-general affair has highlighted Mr Howard's flawed judgment as much as Mr Hollingworth's. In practice, the prime minister chooses the governor-general without consulting even his cabinet, let alone the public. There is no mechanism for dismissing a governor-general, other than the prime minister asking the queen to do so. Mr Howard's decision to choose an Anglican church leader, blurring the separation of church and state, came in for criticism when he appointed Mr Hollingworth in 2001. There were calls for Mr Hollingworth's resignation when allegations over his inaction against paedophiles surfaced in early 2002.

Mr Howard, probably Australia's most staunch monarchist, successfully campaigned, in a referendum in

1999, to keep the queen as head of state. Yet the impasse over the governor-general has exposed the dangers of stubborn resistance to the constitutional evolution that many Australians would support. Public respect for the vice-regal office has crashed. Opposition parties, who have a majority in the Senate, the upper house of Parliament, introduced a motion declaring that “the governor-general was no longer able to exercise the constitutional powers...in a manner that will be seen as impartial and non-partisan”. George Williams, a constitutional expert, argues that no replacement to Mr Hollingworth should be appointed until the position's “structural defects” have been remedied: a plea for a more transparent means for selecting the next one. This would mean another referendum, and this time making the buck stop in Canberra, not Buckingham Palace.

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America and the Koreas

Friends in need

May 15th 2003
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Bucking up the alliance

COUNT on North Korea to spoil a party. This week South Korea's prickly neighbour announced that it has officially scrapped (after unofficially violating for years) a joint agreement to keep the peninsula nuclear-free, and is preparing defences “to destroy aggressors at a single stroke”. But not even that tiresomely blood-curdling threat could dampen relief among South Korean officials at the friendly outcome on May 14th of the first summit between their new president, Roh Moo-hyun, and America's George Bush.

The two men still have their differences. South Korea would like to rule out any resort to force to deal with North Korea's nuclear provocations; America, its chief ally, will not, although Mr Bush has said repeatedly that he has no intention of invading North Korea. Yet the two presidents could unite in insisting that North Korea must give up its nuclear-weapons ambitions in a “verifiable and irreversible” manner. They would not “tolerate nuclear weapons” in the North. Both said that they would like to see this achieved diplomatically. What is less clear is how they will manage either feat.

North Korea's threats, along with its recent admission that it has a hitherto secret uranium-enrichment programme, and its claims, in the wings of talks with America and China last month, to have built two nuclear bombs already and to be readying enough plutonium from spent fuel-rods for more, helped Mr Roh and Mr Bush to sound companionably tough. Yet they have reason for seeing the North Korea problem differently.

Mr Roh's chief concern is stability on the peninsula, where the crisis is already affecting confidence in South Korea's economy; military conflict, he says, would be a “calamity” for South Korea. America, with 37,000 of its troops stationed in South Korea, is not looking for a fight either. But it worries that North Korea's nuclear ambitions, left unchecked, could pose a wider threat, provoking an arms race in the region and encouraging nuclear proliferation elsewhere.

Mr Roh hopes he has nudged the debate inside the Bush administration towards further direct talks with North Korea. In recent weeks South Korean officials have pursued the idea of a “road map” in dealing with the North. Their ideas, says one Bush official, “show a great deal of realism about the incentives and disincentives that can be combined”. But South Korea is unlikely to want to apply any sort of real squeeze on North Korea over the nuclear issue until more negotiation has been tried first. For America, however, diplomacy is not just about talks; the Bush administration has already hinted at a crackdown on North Korea's illegal trade in drugs and counterfeit currency, and if possible on its missile sales too.

But Mr Roh had more than North Korea on his mind this week. He rode to power in February partly on swelling anti-American sentiment, especially among younger South Koreans, but has since sought to reaffirm his commitment to the alliance. He was thus a strong supporter of the war with Iraq, and American officials were both surprised and pleased at his decision to send non-combat troops to help with the reconstruction there. In the past Mr Roh had argued that American troops should leave South Korea. But as president he has learned that they are essential for its security. So much so that he wanted this week to scotch Pentagon plans to redeploy some of the American forces, especially those nearest the border with North Korea. This might make military sense, but Mr Roh worries it will send the wrong signal to North Korea, at least until the nuclear crisis is resolved.

And the sooner that can happen, the better. Like his predecessor, Kim Dae-jung, who got a dustier response in Washington at his first meeting with Mr Bush two years ago, Mr Roh would rather pursue engagement with North Korea. Yet its ever more blatant nuclear claims make that hard to do. Before the Roh visit, South Korea's foreign minister, Yoon Young-kwan, called on North Korea to “give a boon” to those in the Bush administration who favour talks. North Korea wasn't listening. But Mr Roh got on well

in Washington anyway.

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Marshall Islands

The blue lagoon

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A new agreement for America's missile range

IT IS perhaps the least pacific part of the Pacific. Kwajalein atoll, in the Marshall Islands, bristles with radar, optical sensors, telemetry-receiving stations and other ballistic-missile testing equipment. Situated roughly equidistant from Hawaii, Japan and Australia, the atoll encircles the world's largest lagoon. It is the only place on earth where, under the anti-ballistic missile treaty, the United States was allowed to test its strategic interceptor missiles, a key component of President Bush's missile-defence programme, sometimes known as Star Wars II.

No wonder that it has taken four years of wrangling for the Americans and the Marshall islanders to reach agreement on a new 20-year “compact of free association”, which allows the atoll to be on the receiving end of missiles until 2066. In return, the tiny Pacific state, with around 50,000 inhabitants, is to receive $3.1 billion. The islanders will also continue to be able to live and work in America.

The owners of land on Kwajalein are crying foul. They boycotted the compact-signing ceremony on April 30th, and are demanding an additional $4m a year from the Americans. They claim the Marshall Islands government has no right to bargain away the rights of indigenous inhabitants of Kwajalein, who were moved by the Americans to nearby Ebeye in the 1960s. Ebeye is a slum, in marked contrast to conditions at the opulent American naval base, only three miles away, with its close-clipped lawns, a country club and golf course. Fortunately for the Americans, the existing Kwajalein lease runs until 2016. Only the broader compact has had to be agreed by the Marshallese parliament and the American Congress this year.

The Americans took control of the Marshall Islands from the Japanese after the second world war, and turned the area into a testing ground for nuclear weapons. A device believed to be 1,000 times more powerful than the Hiroshima bomb exploded over Bikini atoll in March 1954. The Bikini islanders were evacuated, but the fallout from the blast hit Rongelap and other atolls. As part of the first compact deal in 1986, America paid out substantial sums in settlement for claims arising from its nuclear tests.

Although the Marshallese president, Kessai Note, has only a slim majority in the country's parliament, it is probably enough to get approval for the compact. But the opposition, which includes members from Kwajalein and other atolls that suffered from nuclear fallout, will make use of the compact issue in the general election due in November.

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Islam in Central Asia

Religion, politics and moderation

May 15th 2003 | DUSHANBE AND TASHKENT
From The Economist print edition

Contrasts between Uzbekistan and Tajikistan

DILOROM'S husband is behind bars, together with his two brothers. He was sentenced to 12 years, accused of being a member of Hizb-ut Tahrir (HT), a radical and anti-western Islamic movement that wants to recreate a caliphate in Central Asia. She maintains that the police planted HT leaflets on him, and that her family's only "crime" is to be religious. Earlier this year she protested at one of Tashkent's markets together with 40 other women who were demanding that their husbands be released; they were beaten up by the police and arrested.

An estimated 6,500 people are in jail in Uzbekistan because of their religious or political beliefs. More than half are accused of being HT members, while most of the others are branded as Wahhabis, who practise the Saudi brand of Sunni Islamic extremism. Following the collapse of the Soviet Union in 1991, there was a great revival of religious activity in Central Asia. Mosques mushroomed, partly supported by Pakistani and Saudi money. A brand of radical, internationalist Islam gave birth to the Islamic Movement of Uzbekistan (IMU) and HT. In 1999 and 2000 fighters of the IMU in Tajikistan attempted incursions into Uzbekistan. Terrorist attacks in Tashkent in 1999 were attributed by the authorities to Islamic radicals, and were dealt with ruthlessly.

The threat of Islamic extremism appears to have receded somewhat today, partly due to repression but also to the 2001 American-led invasion of Afghanistan and the defeat of the Taliban. HT, outlawed in Tajikistan, Kirgizstan and Uzbekistan, has been pushed further underground by repression, in particular in Uzbekistan. Most observers agree that the IMU is, for now, a spent force. Having set up bases in northern Afghanistan, it was largely wiped out during fighting around Kunduz and lost its Taliban and al-Qaeda sponsors. Its leader, Juma Namangani, is believed to have been killed, although rumours circulate that he survived. Fewer than 100 isolated remnants are thought to be somewhere between southern Tajikistan and northern Afghanistan, as a foreign diplomat puts it, "sitting in a valley, licking their wounds and thinking what to do next".

Although there are legitimate concerns about Islamic radicalism, authorities in the region have been accused of using the fight against terrorism to crack down on political opposition and justify their control over religious activity. According to the New York-based Human Rights Watch, religion in Uzbekistan becomes criminal as soon as it strays out of official, state-controlled Islam.

In 2001, Muhammad Sadik, Uzbekistan's former chief mufti, returned after living abroad since 1993, when he had been threatened with arrest. Over tea, the stern Mr Sadik explains that the root of extremism is ignorance about the true teaching of Islam, and that the lack of proper dialogue and teaching in mosques is a serious problem. He has been allowed to publish some of his work and speak about moderate Islam. He receives visitors eager for his guidance on religious issues. But he says his activities are closely controlled. When asked about independent Islam in Uzbekistan, he says, "There is no room for the development of moderate, non-state-controlled Islam today."

A form of moderate, nationalist Islam has emerged in Tajikistan, however. The Islamic Revival Party (IRP), the only legal religious party in Central Asia, was part of a coalition of anti-government forces during the civil war that engulfed Tajikistan in the 1990s. Following a peace agreement in 1997,

members of the Islamic movement received government positions, to the dismay of neighbouring Uzbekistan.

The IRP appears to have maintained its commitment to give up weapons and work within the constitution. Muhiddin Kabiri, the IRP's deputy chairman, is the modern face of the party and the symbol of a new generation. In his jeans and a swanky black jacket, this political scientist, who joined the IRP in 1998, contrasts with the IRP's old guard, some members of which have been resisting the party's evolution. The IRP, he says, supports a secular democratic state but would like to inject more religious and traditional values into political life and the legal system. He points at Turkey as an example.

But the IRP has little political influence. President Imomali Rahmonov has gradually consolidated power in his hands. This has provided some guarantee against the disintegration of the country, but is stifling the development of a democratic political opposition. There is some concern among opposition politicians over proposed constitutional changes. Among other matters, there are plans to ease Mr Rahmonov's re-election, and to increase the president's power over the judiciary. The government is also seeking to formalise the influence of the state on religious affairs, but this is not a constitutional matter.

According to Mr Kabiri, the IRP now finds itself in the position of being too Islamic for the government, but is seen as a sell-out by more radical Muslims. He deplores the centralisation of power, yet insists that maintaining the country's stability and avoiding confrontation are important. This could benefit a more extreme form of Islam, however, as ordinary people do not have many ways to channel their discontent. HT's influence is thought to have branched out from the country's Uzbek minority in the north to disgruntled Tajiks trying to appease, as one foreign diplomat puts it, “their unsatisfied hunger for criticism”.

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Correction: North Korea's missiles

May 15th 2003
From The Economist print edition

Flat-earth thinking. Thank you to those readers who pointed out that, by superimposing concentric circles on a Mercator projection, the map in our May 3rd issue (now corrected online) greatly underestimated the potential reach of North Korea's missiles. We stand corrected.

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Congo's war

Waiting to be rescued

May 15th 2003 | NAIROBI
From The Economist print edition

AP

The UN wants to stop the massacres in eastern Congo. But how?

Get article background

POOR Kofi Annan. Just when he thought things couldn't get any worse, Congo proved the UN's secretary-general wrong. On May 6th, Uganda withdrew its occupying troops from Bunia, a town in Ituri, in north-eastern Congo. Chaos followed. The town's 700 UN peacekeepers, largely Uruguayans, found themselves cowering under a shower of mortars and grenades, while tribal militias looted, murdered and maimed their victims in the rutted roads outside the UN's barracks.

As the battle for Bunia rages on, 10,000 terrified civilians have taken refuge in the UN compounds. With little food or clean water, their babies are already dying. And with tens of thousands more people fleeing into the hilly killing fields outside the town, the UN has given warning of a possible genocide. Other outsiders have taken notice. On May 13th, France agreed in principle to send its soldiers to the rescue, after Mr Annan begged for a “coalition of the willing” to sort out the mess.

Whether France will actually deploy troops to Bunia remains in doubt. Wary of becoming embroiled in an unstoppable slaughter, and of the damaging publicity that this might bring, the French government wants allies. But America has refused to join, and Britain is already fully committed in Iraq. There are no other likely candidates among—in Mr Annan's careful phrase—“governments with capacity”. And the plight of his hapless Uruguayans has shown, not for the first time, the futility of sending ill-equipped soldiers to police third-world wars.

Last week, the besieged peacekeepers fired the mission's first shots in earnest, into a violent crowd of civilians and militiamen who were attempting to storm their razor-wire perimeter. In fairness, the Uruguayans had tried to negotiate, but failed; their brave French commander was slashed across the chest with a machete.

Carla del Ponte, the UN's war-crimes prosecutor, says that the killing in Ituri “could be genocide”. This suggests a bid to shock rich governments into helping. Or, perhaps, Ms del Ponte simply knows little about the Congo war. A recent estimate by an American aid agency, the International Rescue Committee, puts the death toll at between 3.1m and 4.7m people, most of whom perished from the starvation and

disease that result when civilians are in almost perpetual flight from armed men.

The inferno began when Rwanda and Uganda invaded Congo in 1998, sparking a convoluted regional war, of which this week's calamity is but a small part. The Congolese government has no sway over its eastern provinces, such as Ituri. Uganda, which shares a border with Ituri, has tried to rule it through proxy militias. It has armed both of the large local tribes, the Hema and the Lendu, pitting each against the other, and fuelling a wave of tit-for-tat massacres which have claimed tens of thousands of lives. On a recent visit, your correspondent saw the burned villages and freshly scattered graves of both tribes.

Congo is not Rwanda: it lacks the sophisticated, authoritarian political arrangements that enabled the Hutu government in 1994 to order the extermination of the Tutsis, and nearly to succeed in exterminating them. It is a small mercy, but the killing in Ituri is less systematic.

Panicked into action, Mr Annan is presenting Ituri's war as a special case for intervention. It is not, in fact, so special, rather a particularly grisly example of a dozen or more micro-conflicts bubbling in eastern Congo, most of them within Rwanda's much larger sphere of influence to the south. These conflicts feature a bewildering and constantly mutating horde of rebel and tribally-based militias, most of them armed either by Rwanda, Uganda or Congo's government in Kinshasa.

No help in sight

Who will put an end to this nightmare? Clearly it cannot be the UN, which can barely raise half its mandated complement of 8,000 peacekeepers, and spends almost half of its $600m annual budget just flying over Congo's vast, roadless forests. Nor can it be the Congolese government, which sent 600 policemen to Ituri ahead of the Ugandan withdrawal, only to see them sell their guns to the Lendu militia, and then take refuge themselves in the UN barracks. A little embarrassed, the government next sent its human-rights minister with a suitcase full of cash and orders to buy off all sides. Now, he is in the barracks too, being treated for hypertension.

All this is meat and drink to Uganda's president, Yoweri Museveni, who has labelled the UN peacekeepers a bunch of “dangerous tourists”. This is rich, coming from the head of the regime most culpable for events in Ituri, and which continues to meddle there. On leaving Bunia, Ugandan soldiers donated their artillery to Hema militiamen, including many who belonged to a murderous gang that the Ugandans had attacked and driven from the town in March. With these weapons, the Hemas retook Bunia from the Lendus on May 12th, sending the pendulum of tribal murder swinging the other way.

Despite pressure from South Africa, Mr Museveni has refused to endorse the mooted French intervention. Perhaps he means to volunteer a return of his own men. That would be bad news for Ituri's ravaged people—though any intervention might please the Uruguayans, who must want to go home, whatever happens.

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Sudan's war

Peace, the unimaginable

May 15th 2003 | KHARTOUM
From The Economist print edition

American pressure is nudging Sudan towards peace. But there is far to go

Get article background

NHIAL BOL'S earliest memory of war was of seeing tanks rolling through the fields near his home. That was in 1967, when he was five. The war began in 1955, when most Sudanese people's parents were not yet born. The fighting paused between 1972 and 1983, but then resumed.

Southern Sudan, the mainly black and Christian or pagan region where Mr Bol comes from, is in ruins. In the country as a whole, the war has killed between 1m and 2m people since 1983, and prompted 4m to flee their homes. The government has sought to starve the Sudan People's Liberation Army (SPLA), the main southern rebel group, of food and recruits, by depopulating the areas where it operates, especially where there is oil. Mr Bol's parents, for example, had to abandon their home five years ago, when government bombers obliterated their village.

By this time, Mr Bol had moved to the capital, Khartoum, in the north. He is safe from the shrapnel, but not from the government. As the editor of a feisty independent newspaper, the *Khartoum Monitor*, he has been arrested 28 times, he says, for transgressions such as inciting hatred of the state and misquoting the Koran. Last week, the *Monitor* was shut down and Mr Bol spent another uncomfortable night behind bars. The government often cites national security as an excuse for this sort of thing. “It's normal,” says Mr Bol.

The war has lasted so long that people find it hard to imagine it ever ending. But this year, it might. The government and the SPLA promised to sign a formal peace deal by June. This deadline will probably be missed, they concede, but both sides do seem to be negotiating seriously, for the first time.

Foreign pressure has been crucial. If the Sudanese government does not negotiate in good faith, America has threatened to choke it with economic sanctions and bankroll the SPLA. The regime thinks this unfair, but it takes threats from the Bush administration seriously, so it has made enough concessions, at least on paper, for the Americans to declare last month that it was indeed showing good faith.

President Omar Bashir has other reasons for wanting peace. His government is tired of being a pariah. It wants respectability, aid, and American firms to help pump Sudanese oil. Even before September 11th 2001, it was trying to convince America that it no longer supported terrorism. It asked Osama bin Laden, who lived in Sudan in the mid-1990s, to leave, and it shared intelligence with Washington.

In the past year, it has also drastically reduced the amount of slave-trafficking on its territory, by stopping a train whose mounted escorts used to capture southerners and sell them. The government denies that slavery exists in Sudan, but some northerners, including Mr Bol's jailers, habitually refer to black southerners as *abid*: Arabic for “slave”.

The SPLA also has reason to make peace. The government's oil revenues are rising fast, allowing it to buy more helicopter gunships. In a country as vast as Sudan (imagine seven Germanies with hardly any roads), a rebel movement that relies on young boys to carry its supplies on foot is extremely vulnerable to air power.

So a deal is possible. A ceasefire signed in February seems to be holding, more or less. Negotiators met in Kenya last week to start a fifth round of talks about power-sharing. The details will be tricky. How much power will the government surrender, and how much of the oil money? Ministers insist that a proposed transitional government will be democratic. Maybe, but neither of the parties that will dominate

it—the current regime and the SPLA—has much experience in this area.

Those who expect to be left out are furious. In the western region of Darfur, a new rebel group briefly captured an airport and killed 75 soldiers last month. The government dismissed them as “bandits”, but if so, they are well-organised ones.

Even a flawed peace would be better than none, as the success of an internationally-monitored ceasefire in the Nuba mountains, signed in January last year, illustrates. This black enclave in central Sudan, where the government and SPLA used to trade atrocities, is now remarkably calm. Villagers who cowered for years in camps, subsisting on food aid, have returned to their fields, sunk new wells to replace the ones the men with guns blew up, and started farming again. The vaccination rate for children in some areas has gone from zero to 100%.

Relief efforts are hindered, however, by the government's authoritarian mindset. Foreigners, even accredited aid workers running projects officials admit are life-saving, need a permit each time they leave Khartoum. This can take a week or more. The government should be publicising its success in Nuba, but your correspondent could not get a permit to visit it.

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Swaziland's monarchy

Celebrating 30 oppressive years

May 15th 2003 | JOHANNESBURG
From The Economist print edition

With hope and crossed fingers for a constitution

SWAZILAND, the tiny mountain kingdom on South Africa's edge, has been under a state of emergency for 30 years. This allows it to hold elections of a kind, but bans opposition to the monarchy, forbids political parties, and denies women the right to own land. Recently, King Mswati III has been happily crowing about his one-man rule.

Last month, for example, he addressed 400 sycophantic clergymen at a snappily-titled conference on “The disadvantages of multi-party democracy”. To murmurs of approval he told them that “democracy is not good for us because God gave us our own way of doing things”. Responding to his speech, a dutiful cleric pointed out that if people get the right to choose leaders, they always choose evil.

A grand protest that was planned last month to mark the 30th year of repression fizzled into nothing. A few newspapers dare criticise officials, but not royalty. Lawyers offer almost the only resistance: the chief justice of the High Court, and the entire bench of the Court of Appeal, resigned because of government meddling; and two senior lawyers have been threatened with deportation for criticising misrule.

South Africa mildly expresses its unhappiness about censorship. But its criticism is muted, perhaps because 70 South African chiefs who live near the Swazi border say they want the frontier shifted so that their territory, and 1m South Africans, can become part of the kingdom. Britain might be thought to be concerned with democracy, but this week Queen Elizabeth played host to King Mswati without making a fuss.

Seven years ago, Prince David Dlamini, a diplomat, was told to write a constitution. He got help from the Commonwealth, especially experts from Tonga and Ghana, and looked at 19 other constitutions, mostly in Africa. Many had long given up believing it would ever be seen, but Prince David now says that it may be made public in the next week or two. He also says that he is “hoping and crossing fingers” that it will come into force before the elections due in the second half of the year. Well, if so, it would be a start, of sorts.

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Rwanda's genocide trials

On a patch of grass

May 15th 2003 | KABUGA
From The Economist print edition

A slow start to the traditional courts that will try the lesser villains

AP

Persuading people to say what they saw

Get article background

ALL over Rwanda, foreign-financed billboards seek to persuade people that “the truth heals”. Maybe so, but it can also incriminate. Virtually all Hutus either took part in the 1994 genocide, or know someone—a friend, a family member—who did. So most of them are reluctant to give evidence to the traditional courts charged with figuring out who killed whom. Tutsis are more willing to testify, but since those who survived often did so by hiding in dark places such as pit latrines or church crypts, they generally saw little.

Judging the genocide was never going to be easy. Perhaps 800,000 people, mainly Tutsis, were murdered in 100 days. Hutus who protested were also hacked to death. Until this year, there were more than 100,000 suspects in jail awaiting trial. The formal courts will never be able to try more than a fraction of them, so the government has said that the lesser alleged perpetrators (but not the ringleaders) can be tried before *gacaca*: traditional courts once reserved for spats over stolen cows.

Gacaca courts are supposed to be rough, cheap and the main means of Hutu-Tutsi reconciliation. They got off to a flying start: in October 2001, Rwandans elected 258,208 *gacaca* judges, including 19 for each of the country's 9,170 “cells” (tiny administrative units sometimes as small as 200 people). The people of each cell are supposed to assemble before these judges on a patch of grass (*gacaca*). By hearing testimony from everyone who was there during the genocide, the judges are supposed to identify the culprits, and then pass judgment on them. But progress has been slow.

After a year and a half, a pilot project is compiling lists of the dead and their alleged killers. Only when this task is completed, possibly in June, can the first proper trials begin. The whole process is supposed to last four or five years, but officials admit that this may not be long enough.

A visit to a typical *gacaca* session gives an idea why. About 100 people have gathered in a grove of tall trees in Kabuga, a village outside Kigali, the capital. Evanice Mukamusoni, one of the judges, is struggling to persuade any of them to talk. There is a mass grave in the village, now with houses built on top of it, containing hundreds of bodies. Does anyone know anything about it? There is silence.

Ms Mukamusoni, a Tutsi whose husband died in the genocide, wags her finger at reluctant witnesses. Seeing a crime, she counsels, is not the same as committing it. Still, nobody speaks up. Changing tack, she reads from the *gacaca* statute: “The law punishes those who do not tell the truth.” Silence, again. At a meeting a week later, a man, who lives only 50 metres from the mass grave, is questioned closely, but he says that he never noticed it, as he is not the curious type.

About 85% of Rwandans are Hutus, who generally feel that the justice system is rigged against them. *Gacaca* courts are not allowed to try cases where Hutus were killed by the invading Tutsi army that stopped the genocide, and whose leaders now run the country. Such accusations are often raised at *gacaca* meetings, but officials insist that they can only be handled by normal courts. They rarely are, complain human-rights activists.

Gacaca hearings are often delayed when not enough people show up. This is hardly surprising. Most Rwandans are subsistence farmers. They typically spend one day a week at the market, another at church and perhaps a third doing compulsory community work. They could not spare a whole day each week to sit around talking, even if they wanted to, which they generally do not. It is only because Rwandans have such a long tradition of obeying orders that any *gacaca* sessions take place at all (a tradition that also helps to explain the genocide itself).

On January 1st, Rwanda's president, Paul Kagame, undermined the *gacaca* system by announcing the release on bail of 40,000 prisoners who had confessed to crimes related to the genocide. Most of these were either elderly or very young, or had already served time appropriate to their alleged crimes, but many survivors were furious to see them walk free.

What was Mr Kagame's motive in freeing the 40,000? Money, perhaps. The cost of keeping genocide suspects in jail is a crushing financial burden for the government, even though prisoners are fed by their families or the Red Cross. Electoral politics may also have been a factor. Some time this year, Rwanda is to hold its first election since the genocide. Mr Kagame's party will contest it—and prisoners have families who vote.

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France's pension reforms

The unions say no. But might the government outmanoeuvre them?

May 15th 2003 | PARIS
From The Economist print edition

AFP

Huge protests tie up the country. We'll go ahead, says the government

Get article background

"THE street can give its views, but the street doesn't govern," said the prime minister, Jean-Pierre Raffarin, just before huge demonstrations on May 13th against his plans for pension reform brought France almost to a halt. Is he right? Or will the protests fatally undermine his government, as happened to his party colleague, Alain Juppé, an earlier prime minister who attempted fundamental reforms? For all the scale of the demos (the trade unions claim 2m people took part, the police guess is 1m), the odds must favour Mr Raffarin.

One reason is that Mr Juppé's downfall came when President Jacques Chirac rashly called early elections in 1997, letting those millions of voters who had taken to the streets in 1995 have their say at the ballot box too. He will not make the same mistake twice; the next general election will not be until 2007. Second, unlike the intellectually arrogant Mr Juppé, Mr Raffarin is rumpled and friendly; he can talk of "grassroots France" without seeming to despise it. Third, even his most dogged opponents recognise that as people live longer, some pensions reform is a necessity.

Mr Juppé's attempt at it, prepared in secret, came as a bombshell to public opinion. Mr Raffarin has spent months consulting just about everyone. Add a huge centre-right majority in parliament and an opposition in disarray, and he may well seem safe enough.

Yet the security is relative, especially as some strikes continued beyond the one day originally planned. As *Libération*, a leading paper of the left, pointed out on May 14th: "It's not the street that governs, but it's the street that gives a government a slap in the face—and since yesterday Raffarin's cheeks are red." And public opinion is in two minds: pollsters find a majority agreeing that the pensions system must be reformed, but 48% are against Mr Raffarin's proposals and only 42% for them—with two-thirds supporting the demonstrators.

That is no great surprise. One essential element of the reform is that public-sector workers, who can now retire on full pension after just 37½ years of contributions, will by 2008 have to work the same 40 years as their counterparts in the private sector; and a quarter of France's workforce is in the public sector, while half of all households have at least one family member there. Another proposal is that, as life-expectancy increases, so should contribution periods; for example, to 41 years by 2012 and to 42 by 2020. Many young people feel they're being condemned to work for ever.

Nor is the economy supplying any countervailing feel-good factor. Unemployment in March was 9.3% of

the workforce, up from 8.9% a year earlier; and investment, household spending and consumer confidence are all weakening. Moreover, the European Commission and France's EU partners are telling France to slim its public-sector deficit from this year's likely 3.7% of GDP and its public debt, some 61% of GDP, as against the EU limits of 3% and 60% respectively.

Mr Raffarin's response has been to talk tough—but not too tough. He has told ministers that the state "must not spend a single euro more" next year than this, while rejecting "a France of rigour, because rigour means more taxes and higher charges." Similarly, he has told the unions he will be tough on those who want to block reform but will listen to "constructive suggestions". Even before meeting the unions on May 14th, the social-affairs minister, François Fillon, said there was room to negotiate on several issues: a rise in the minimum pension for the low-paid, for instance, or over penalties on those who retire after paying too few contributions.

Crossed fingers

Whether this makes financial sense is doubtful. Short of an unexpected and sustained burst of economic growth, most pundits reckon that even unmodified the reform package will not be enough to pay for pensions over the next 40 years. But it makes good political sense. Mr Raffarin has to juggle Mr Chirac's insistence on cutting taxes, his commitment to pensions reform and the European Commission's insistence on balanced books. The effort looks likely to fail; but as the unions prepare yet more strikes in the run-up to next month's parliamentary debate on the reform, at least Mr Raffarin can hope to escape the fate of Mr Juppé.

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German foreign policy

We're not children!

May 15th 2003 | BERLIN
From The Economist print edition

Germans are still rethinking their relations with America and the world

Get article background

EVEN before the Iraq war began, Germany was feverishly trying to repair what its chancellor described last week as its “vital friendship” with the United States. In the past few weeks, there have been signs of a thaw. Noises on each side have become gentler. Visits between top people have resumed. Colin Powell, America's secretary of state, is to visit Berlin on May 16th to talk to his German counterpart, Joschka Fischer, and to Chancellor Gerhard Schröder. At the end of this month or early next, it is conceivable that the chancellor and President Bush, who have not spoken to one another since last November but are due to meet first in St Petersburg and then at the G8 summit in Evian, in France, may again clasp hands.

So talk of “normalisation” is in the air. But can relations between Germany and America ever return to what they were before all the bitterness and mud-slinging of the past nine months? Or has there been a tectonic shift in Germany's foreign policy, leading to a permanent loosening of ties with America in favour of an even closer attachment to France, whose hostility to American hegemony is traditional? No one, Mr Schröder said last week, should try to force Germany into a “senseless choice” between its two key allies. But Germany is surely looking at itself and its role in the world in a new way that is bound to trouble some of its allies, particularly the Americans.

In fact, this process began when Germany regained its full sovereignty after reunification at the end of the cold war. At first cautious, it has gradually begun to play a bigger part on the world stage. There was some unease when Mr Schröder declared, on taking office in 1998, that Germany had “come of age” and now intended to pursue its own national interests “without a complex”, like any other country. But most leaders elsewhere, particularly in America, applauded the Germans as they began to break historic taboos, for instance by sending troops into combat zones for the first time since the second world war, first in Kosovo, then in Afghanistan. Germany now has more troops involved in peacekeeping missions than any other country, bar America and Britain.

German diplomats used quietly to boast that, though America's closest relationship was with Britain, its most important one was with Germany, the world's third biggest economic power, placed strategically at the heart of Europe. So why, ask American diplomats, did Mr Schröder risk Germany's relegation to the international sidelines? A senior American asserted in January that the chancellor's strident opposition to a war against Iraq had undone in six months all that had been achieved in the previous 50 years. “Germany has no international voice any more; it has sunk into insignificance.”

Most Germans, naturally, do not see things quite that way. While many, particularly diplomats, were appalled by the style and tone of Mr Schröder's diplomacy over Iraq, most of them nevertheless believe he was right to stand up to the Americans on this score. Yes, of course, say Mr Schröder and his compatriots, they are pleased that a cruel dictator has been toppled. But, no, they still believe that war in this case was unjustified. The chancellor still denies that his early opposition, even to a war with a specific UN mandate, was prompted by electoral calculation. It was, he maintains, a matter of principle.

It was also, he has said more recently, part of Germany's “coming of age”, its “emancipation”. Since the second world war, Germany had done and said pretty much what the Americans had wanted. Now, for the first time, it has dared oppose the world's sole superpower on a truly big issue. Mr Schröder's use of the word emancipation, intended to apply to the whole of Europe and not just to Germany, has added salt to an already open wound. The Americans have protested that the word implies liberation from slavery. Was that how Germans viewed their relations, after all America had done to free them from the Nazis, protect them through the cold war, and support their reunification? The e-word, Mr Schröder

hastened to assure them, meant emancipation “for oneself”, not as an act against anybody.

A former American ambassador to Berlin describes Germany's dispute with America over Iraq as “the opening shot of a new, disloyal, confused and weak Germany. This is not a grown-up but a teenager screaming defiance at the father.” Not so, says Joschka Fischer, Germany's foreign minister. “The transatlantic relationship is indispensable...The power of the United States is a totally decisive factor for peace and stability in the world. I don't believe Europe will ever be militarily strong enough to look after its security alone. But a world order in which the national interests of the strongest power is the criterion for military action simply cannot work.” Amen to that, Mr Schröder would say.

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Germany's finance minister

Under the gun

May 15th 2003 | BERLIN
From The Economist print edition

Hans Eichel, once so solid, is looking more vulnerable than ever

Get article background

Reuters

Iron or rust?

“IRON Hans”, they used to call him. It was Mr Eichel who achieved Germany's biggest tax cuts in half a century, preached a fierce austerity, and stuck rigidly to a policy of squeezing the budget. For two years after taking over as finance minister in 1999 from the left-wing, fiscally extravagant Oskar Lafontaine, Mr Eichel was the government's star. Despite his penchant for spending cuts, he was widely admired for his integrity, courage, and unwavering loyalty to Chancellor Gerhard Schröder.

But as Germany's economy has continued to flop, Mr Eichel has fallen from grace. Since growing by a respectable 3% in 2000, the economy has ground virtually to a halt. Last year it grew by only 0.2%; so far this year it has actually shrunk. Unemployment has climbed since the end of 2000, reaching a seasonally adjusted figure of 4.5m last month, the highest April figure since Germany's two parts were reunited a decade ago. The unadjusted figure used by most Germans could even top 5m this autumn. Bankruptcies are soaring. Spending on welfare is heading for a record.

Mr Eichel admitted for the first time this week that, after last year's deficit of 3.6% of GDP, Germany would fail to keep within the euro zone's 3% limit this year too. It would also miss its goal of balancing the budget by 2006. The country, it seems, is trapped in a vicious circle of slowing growth, dwindling tax revenues, and higher unemployment and welfare spending. Mr Eichel confessed that this year's budget, endorsed by parliament less than two months ago and based on growth of 1% and a deficit of 2.7%, was already out of date. An extra budget would be needed.

The conservative opposition are baying for Mr Eichel's blood. They say he lied to voters before last September's election about how dire the economy really was. His policies, they claim, have failed dismally. Once Europe's power-house, Germany is now its sick man. They say Mr Eichel has no credibility. Time for him to go.

Decent, plodding and bland, Mr Eichel is an easy scapegoat. But he still has Mr Schröder's trust and the support of most MPs in the ruling coalition of Social Democrats and Greens. As long as that lasts, he has no intention of stepping down. Besides, there is no obvious replacement. But these days Iron Hans looks pretty limp.

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Iceland's election

Cod's own country

May 15th 2003 | REYKJAVIK
From The Economist print edition

Iceland's record-breaking prime minister looks likely to hang on

Reuters

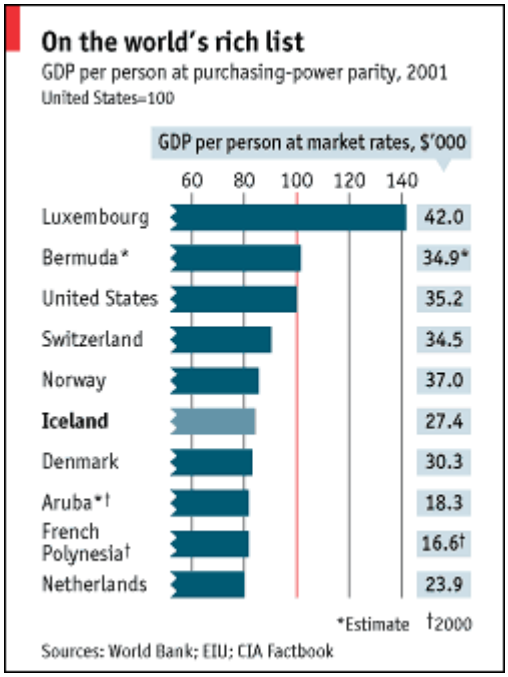
Oddsson on for a bull's-eye

AFTER narrowly winning Iceland's general election on May 10th, David Oddsson, already Europe's longest-serving prime minister after 12 years in the job, may yet beat the record held by Helmut Kohl, Germany's chancellor for 16 years until 1998, as western Europe's longest-serving head of government since 1945. What is the secret of his success?

The main reason is Iceland's remarkable economy. Until last year it had grown by an average of 4.5% a year for five years—nearly twice the European Union average. Plonked in the Atlantic with no resources but fish, geothermal power and its population of 288,000, Iceland has nonetheless managed to make itself the sixth richest country per capita in the world, measured in purchasing-power terms. Though its economy marked time last year, it looks set to expand again this year. Unemployment peaked at just over 3%.

Fish still account for more than half of exports. The government has handled its marine resources cannily, avoiding the worst excesses of overfishing. In the past decade it has also encouraged diversification. Tourism has grown fast. So has the metals industry, with investors attracted by the country's huge untapped reserves of hydroelectric and geothermal power. A new aluminium smelter to be built in the eastern fjords should give a further boost. Privatisation and a new entrepreneurial climate have also pepped things up. Icelandic business has expanded abroad, acquiring—among other things—a big Russian brewery, a Swedish bank, stakes in some of Britain's big high-street retailers, and a minor British football club.

Iceland has managed its human resources well too. Some 8,000 young Icelanders study abroad every year, with America the most popular destination; amazingly, given the bleak climate and long dark winters, some 90% return, This helps keep the country dynamic and open to new ideas. Icelanders are among the world's most active internet users, and publish more books per head than in any other country.



Mr Oddsson, 55, a former actor, journalist and comic playwright, is not without critics—and his conservative Independence Party, now with 22 of parliament's 63 seats, lost electoral ground, dropping from 41% to 34% of votes cast. He must cut another coalition deal with the economically liberal Progressives, who held on to their 12 seats. The left-leaning Social Democratic Alliance, led by Ingibjorg Solrun Gisladottir, bidding to be Iceland's first female prime minister, went up to 31% and 20 seats—and could yet oust Mr Oddsson's lot by going in with the Progressives. Quite a few Icelanders think the spoils of wealth, be they fishing quotas or social benefits, are not being evenly enough spread.

Mr Oddsson, who can be abrasive and sharp-tongued, also faces challenges on the foreign front. He and most Icelanders remain firmly against joining the EU so long as they can enjoy economic ties to the continent as members of the

European Economic Area, which gives them most of the EU's trade privileges (except for fish and food) without letting them have a say in decisions. The country has also been a keen member of NATO, though it has no armed forces of its own; but some Icelanders fear that the Americans will scale down their base outside Reykjavik, while others want them to leave.

Even if he keeps his job, will Mr Oddsson break Mr Kohl's record? Some say he will return to his writing before finishing a full term. After all, Iceland has more statues to poets than to politicians.

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Cyprus

Loosening up?

May 15th 2003 | ANKARA AND NICOSIA
From The Economist print edition

Is there still a chance for a settlement in Cyprus?

Get article background

THREE weeks after Rauf Denktash, the Turkish-Cypriot leader, unexpectedly threw open the borders of his statelet in northern Cyprus, queues of cars still stretch for several kilometres in each direction. By May 15th, as many as 250,000 Greek-Cypriots and 70,000 Turkish-Cypriots—about 40% of the island's combined population—had visited what each community calls “the other side”. The enthusiasm of both sorts of Cypriot for getting reacquainted after 29 years of official hostility has shocked the politicians and offered a new glimmer of hope that an island-wide settlement may be agreed before Cyprus—in practice, the southern (Greek-Cypriot) side—joins the European Union in May next year.

Greek-Cypriots are filling the cafés and restaurants of Kyrenia, a picturesque port on the north side that is known to Turks as Girne, and are gambling in northern casinos that would be banned in the south. They pile trolleys high at supermarkets, where prices are a third of those at home. Meanwhile Turkish-Cypriots visiting the south comb Nicosia's boutiques for luxury brands unavailable in the north and sip caffe lattes in trendy bars. Tearful reunions of elderly neighbours from villages where Greek and Turkish populations once lived together are being shown on television on both sides of the island, with grandchildren fraternising cheerfully in English.

Most first-time trippers say the main reason for crossing the border is to find out what happened to their old homes. “It's a miracle,” says Ozdogan Advinli, a 46-year-old Turkish-Cypriot car mechanic, as he tramps across the “dead zone”, supervised by UN peacekeepers, that separates the Turkish- and Greek-controlled bits of Nicosia, the capital. “I shall finally see Paphos again, the place I was born.”

About 180,000 Greek-Cypriots fled south when Turkish soldiers landed on the beaches outside Kyrenia in 1974 to prevent a union of Cyprus with Greece following a coup plotted in Athens. Some 40,000 Turkish-Cypriots moved north. Questions about handing back property or paying compensation will loom large in negotiating details of a settlement. Thousands of mainland Turkish settlers have moved into homes owned by Greek-Cypriots.

Mr Denktash opened the border a week after Tassos Papadopoulos, the new Greek-Cypriot president, signed Cyprus's treaty of accession to the EU on behalf of the whole island. Kofi Annan, the UN's secretary-general, had blamed Mr Denktash publicly for the collapse in March, after decades of long and weary on-off negotiations, of the latest UN effort to reunite the island. It offered wide autonomy for the two communities in their separate zones; it also required the Turkish-Cypriots—about 18% of the total population before 1974, but now holding 37% of the island's territory—to hand over 8%.

Mr Denktash still says the Turkish-Cypriots will not enter the EU on May 1st 2004, when the new treaty to enlarge the Union takes effect. But public opinion in the north now overwhelmingly favours joining the European club. President Papadopoulos has called for the UN-sponsored reunification talks to restart as soon as possible, based on the plan Mr Denktash rejected in March. But there is a danger he may make things harder for Mr Denktash by demanding changes to the UN plan for a rotating all-island presidency, to give the Greek-Cypriots the upper hand in a loose federation. The federal government would run Cyprus's relationship with the EU and oversee its judiciary and banking.

Mr Annan wants to be sure that both sides, in particular Mr Denktash, agree to the outlines of a deal before starting, once again, to negotiate the final details. Both sides would also have to agree to hold referendums to endorse a settlement plan. And the UN wants Mr Denktash to accept a timetable.

The rapprochement should consolidate over the next few months as the Greek- and Turkish-Cypriot governments adopt measures to help the two economies converge. Greek-Cypriot hoteliers and builders are looking to Turkish-Cypriots to fill a worsening labour shortage in the faster-growing and by now very much richer south. Turkish-Cypriot wholesalers are keen to sell their fruit and vegetables in the south.

Nationalist politicians warier of cross-community amity warn that just a few violent incidents caused by the settling of old scores could ruin this budding Greek-Turkish friendship and close the border crossing points again. But back at the Nicosia checkpoint, Mr Advinli, the car mechanic, confidently declares that in the end “people power” will prevail. “Turkey, Denktash, the UN: we won't listen to them any more,” he says. “We shall reunite our island ourselves.”

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The Turkish-Cypriots' leader

Rauf Denktash at bay

May 15th 2003 | LEFKOSE
From The Economist print edition

Could a new Turkish-Cypriot leader emerge in time to make a deal?

Get article background

AP

His time is running out

RAUF DENKTASH, the embattled Turkish-Cypriot leader, pours cold water on suggestions that “people power” has changed the equation. He insists that the status quo is working fine; all that is needed, he implies, is international recognition of the Turkish-Cypriots' northern statelet. He says he is delighted that the Greek-Cypriots need to show their passports and get visas to cross over to the Turkish side of the wire. He has even offered to let Greek-Cypriots file claims for property in Turkish-Cypriot courts.

But resentment against Mr Denktash among Turkish-Cypriots, not least poorer ones who think they will become a lot richer if the UN plan is implemented, is growing. Public opinion in the north has swung heavily in favour of doing a deal that would let the whole island join the European Union. On their recent trips south, many Turkish-Cypriots stop at a government office to apply for a Cyprus passport to let them travel and work in the EU. “We're fed up with being isolated,” says Ozdil Nami, an up-and-coming businessman. “We want to join Europe.”

That was one reason why mainland Turkey's new reformist prime minister, Tayyip Erdogan, campaigned bravely last year in favour of the UN plan. But more recently he seems to have been persuaded by Turkey's ever-influential generals, who see northern Cyprus as a strategic asset, to back Mr Denktash and his policies once again. It is not clear, however, that he will continue to do so.

A growing number of Turkish-Cypriots are starting loudly to question the need for some 30,000 Turkish troops on the island. Many accuse their government of corruption. In February a huge demonstration—at one guess, 70,000 people, a third of the Turkish-Cypriot population, including prominent businessmen and trade-unionists—marched through northern Nicosia shouting slogans against Mr Denktash, with placards that read, “Yes to peace, Yes to the EU.”

Mr Denktash, now 79, looks haggard. He had a major heart operation in October. His legendary charm and pugnacity are fading. The demonstrators, he says, were “on the pay list of foreign powers”. Most Turkish-Cypriots, he insists, are behind him. But it is unlikely that he believes his own words. And he may be running out of time. A general election is due in his self-styled “republic” in December, and opposition parties may well get a majority in its parliament. A new Turkish-Cypriot government could then press Mr Denktash to resign and would appoint a new negotiator readier to see the merits of the UN plan.

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Charlemagne

Comparative corruption

May 15th 2003
From The Economist print edition

Different standards of probity across the continent pose a problem for the European Union

THEY must rank as the most expensive nappies in history. The diapers, chocolate and scent that Mona Sahlin charged to her government credit card in Sweden in 1995 cost *euro*70 ($80)—and a promising political career. Tipped as a future prime minister, Ms Sahlin's fortunes never recovered from the nappy affair and a subsequent revelation that she had failed to pay parking tickets.

It takes a lot more to end a political career in France or Italy. Silvio Berlusconi, Italy's prime minister, is on trial in Milan accused of trying to bribe a judge back in the 1980s. It is just one of a string of criminal cases Mr Berlusconi has had to fight off, with charges ranging from false accounting to bribery, while keeping his political career and business empire in shape. Having failed to get his most recent case transferred to a supposedly more sympathetic jurisdiction, Mr Berlusconi is now hoping to push through a law to grant immunity from criminal prosecution to Italians with “high state roles”. A similar immunity rule helped Jacques Chirac, France's president, avoid facing charges of financial crimes allegedly committed during his long stint as mayor of Paris. When Mr Chirac ran for re-election as president last year, opponents produced a fake election poster with the slogan “Vote for me or I go to jail!”

While Mr Chirac is exempt from prosecution, the trial of former executives of the French oil company, Elf-Aquitaine (as it was formerly called), now under way in Paris, is yielding some startling insights into other corners of the French establishment. Elf, it seems, operated for many years as the unofficial slush fund of the French state, paying for everything from the suborning of African dictators to the election campaigns of the main right- and left-wing parties and lavish homes for selected executives. When Loïk Le Floch-Prigent, the former chief executive, was questioned about the use of Elf money to buy him a Paris house for *euro*9m, he admitted apologetically that “things did get a bit out of hand”. As for the use of a further *euro*4.5m of company money to fund his divorce, the former CEO suggested that this had been done at the direct suggestion of François Mitterrand, then France's president, who had been keen to ensure that Mr Le Floch-Prigent's estranged wife did not reveal any embarrassing secrets about Elf.

At least the French and Italian cases have come to trial. Not so the scandals surrounding Helmut Kohl, who used to be chancellor of Germany, and the illegal campaign contributions he marshalled for his Christian Democratic Union. There have long been allegations that some of his party's cash pile came from Elf, as a political favour from Mitterrand. But the former chancellor isn't telling. Though he has admitted that he ran a network of secret accounts stuffed with illegal campaign contributions, Mr Kohl says that honour prevents him from revealing the donors' names. His staff conveniently destroyed many potentially relevant computer files in the days before he left office.

In years gone by, revelations of corruption could be treated by people in other countries as good, dirty fun—and often as a welcome chance to confirm national stereotypes and scoff at neighbours. But in these days of deepening European political integration, different ideas about what constitutes corruption pose a real problem.

In July, Italy will start presiding over the European Union for six months—and Mr Berlusconi will become the Union's public face. The fact that he will be simultaneously on trial for corruption, even if no verdict is handed down during the Italian presidency, is causing a few winces. Even if he is innocent, the implications for the EU are not entirely reassuring, since his defence is based partly on the argument that Italy's judicial system is utterly politicised and unreliable. Hardly a reassuring portrait of a country with the fourth-biggest economy in the EU.

A sense of mistrust between EU countries is not an abstract or occasional problem. It affects their day-to-day dealings. Consider the past week's goings-on in Brussels. The Union's finance ministers were in town,

trying to nail down a deal on a pan-European savings tax to combat tax evasion. But Italy is refusing to sign on the dotted line until it gets a deal on an utterly unrelated issue: it wants to spread out a fine on Italian farmers who exceeded their permitted milk-production quotas. As one exasperated Eurocrat put it: “The Italians are delaying one anti-fraud measure because they have been caught out under another.”

These problems of mutual mistrust will increase if the EU's plans for much deeper judicial and criminal integration proceed apace. In the wake of September 11th the Union approved plans for a pan-European arrest warrant which will short-circuit traditional and lengthy extradition procedures. But such a measure requires complete faith in the judiciaries of all 25 countries that will join the Union by the middle of next year, including several that have only recently emerged from the former Soviet block. Mr Berlusconi is clearly worried. He warned his colleagues, in vain, that the European arrest warrant might lead politically motivated prosecutors to pursue their quarries across frontiers.

A matter of standards

A new European constitution being drawn up in Brussels at a convention on the EU's future is likely to integrate Europe's criminal-justice systems even more tightly. A draft document produced by the convention's presidium (as its steering committee grandly calls itself) aspires to create a “European criminal-justice policy” replete with a European public prosecutor responsible for “investigating, prosecuting and bringing to judgment perpetrators of serious crimes affecting several member states”. A list of possible crimes is drawn up elsewhere in the constitution's draft. It includes terrorism, drugs-trafficking, racism and xenophobia, and corruption. But which definition of corruption will apply? The one applied to Ms Sahlin? Or the looser one preferred elsewhere in the Union?

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The pound

Why the falling pound brings gloom

May 15th 2003
From The Economist print edition

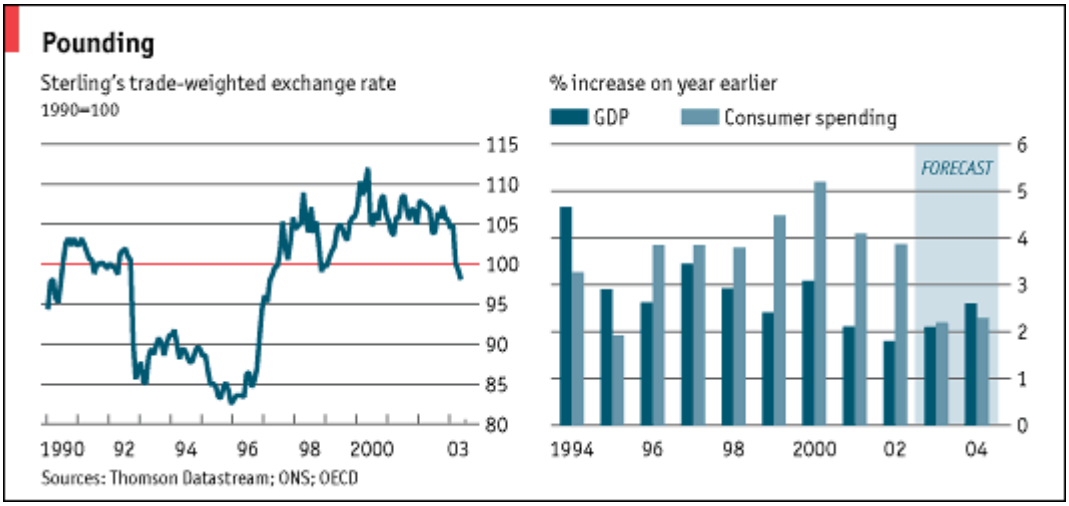
Sterling's weakness spells an end to the feel-good economy

SOMETHING extraordinary happened in the run-up to Labour's landslide victory six years ago: the City's currency dealers drove the pound higher rather than lower. For a party haunted by previous devaluations—Harold Wilson railed against the “gnomes of Zurich”—this was a seal of approval to savour.

Slung out of the ERM in 1992, sterling had sand kicked in its face until mid-1996. Then it started to do the kicking. By January 1999, when the euro was launched, the pound's trade-weighted value (the broadest measure of its worth) had risen by 20%. Over the next year and a half sterling gained still further, particularly against the euro, rising as high as *euro*1.75 in 2000.

There were three main reasons why the pound started to punch its weight. First, Britain restored credibility to its monetary policy so that currency dealers ceased to worry about a return to the bad old ways of high inflation eroding the value of the pound. Second, the economy, and especially the City of London, did well in the 1990s, and this encouraged investment inflows of foreign money. Third, currencies overshoot: dealers marked the pound down too far in the mid-1990s and marked it up too much at the end of the decade.

The strong pound turned a healthy expansion into a feel-good economy. Output increased steadily but scarcely boomed, averaging 2.6% in the six years to 2002. By contrast, consumer spending undoubtedly boomed, growing at an average rate of 4.2%—well above its post-war trend rate of 2.7%. This was partly because consumers saved less but also because household spending power was boosted by the strong pound which kept inflation low.



While consumers flocked into shops to buy cheap imports and on to planes for cut-price foreign holidays, export-reliant manufacturers flip-flopped in and out of recession. A rising deficit on net trade—exports less imports—partially offset the stimulus from the consumer boom, acting as a drag on economic growth for each of the past seven years, a record.

But now the pound has fallen back to earth. So far this year its trade-weighted value has fallen by 6%. The decline since October has been the biggest since the pound left the ERM. The fall has been especially marked against the euro: sterling has dropped to its rate at the launch of the euro in 1999.

Probably the main reason for the fall is simply that the pound had previously overshot. But the markets have also started to question the underlying health of the British economy even though it has coped with the global slowdown more successfully than the euro area. In the late 1990s, Britain's prospects were buoyed by the City of London's strengths when demand for global financial services was booming. Now there are fears that there will be a long winter in international capital markets. That has made dealers worry more about the ability of Britain's manufacturers to take up the slack. Trade figures issued this week underlined the recent weakness of goods exports.

The pound's decline will act as a tonic for the trading sector of the economy. It will allow businesses to step up production for overseas markets and enable them to compete more effectively in Britain with imports. That in turn should help to boost overall growth. The National Institute of Economic and Social Research estimates that a fall of 6% in the trade-weighted value of the pound will boost growth next year by half a percentage point. In its quarterly *Inflation Report*, the Bank of England revealed this week that it is expecting the economy to grow more rapidly next year than it had forecast in February.

But an export-led recovery will be a feel-bad economy. Households will no longer be able to benefit from cheap imports. Nor will they be able to count on further declines in interest rates. The Bank also said this week that it had raised its forecast for inflation because of the recent fall in the pound. This makes it more likely that interest rates will rise later this year. All this comes at a time when rising taxes were in any case due to eat into the growth of disposable incomes.

Gordon Brown will also feel the pinch. The Treasury piggy-backed on the consumer boom of the late 1990s, raking in lots of indirect-tax revenues like VAT. Export-led growth is less remunerative for the chancellor. So even if the economy does grow as rapidly next year as the chancellor hopes, it will not necessarily help him meet his forecasts for the public finances. Worries about looming future tax increases to deal with budget deficits would then add to the feel-bad climate.

Easing the way to euro entry? Hold on

On the face of it, the fall in the pound removes a major obstacle to joining the euro: it has now reached a level where there are fewer worries about over-valuation. But sterling's decline also argues for delay since the British economy now needs to adjust to a lower exchange-rate. The euro area also needs to adjust to its appreciation against both the pound and the dollar.

In Britain, the response is likely to be higher interest rates whereas in the euro area it needs to be lower interest rates. So the current gap between Britain's base rate of 3.75% and the euro area's rate of 2.5%

is likely to widen. That will make Britain less rather than more aligned with the euro area—underlining Gordon Brown's view that Britain has not yet achieved the objective of “sustainable and durable” convergence set out in the Treasury's five tests.

At the same time, the strong euro will hit growth in Europe while the weak pound will reinforce Britain's recovery—hardly a promising backdrop for an early referendum on joining the euro. The euro zone will look less attractive than ever. And, as voters get gloomier, the government will need to focus on keeping them happy by improving public services—which is what it promised to do at the last election.

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Northern Ireland

Truth, lies and Stakeknives

May 15th 2003 | BELFAST
From The Economist print edition

Was the army's top double agent head of the IRA's internal security?

BELFAST, origin of many of Britain's odder stories, this week produced its weirdest one for some time. As so often with tales about the Troubles, it was hard to know what to believe.

The "Stakeknife" story apparently emerged as an unlikely consequence of the pensions crisis. It looks as though two low-level military intelligence agents, disgruntled by the government's failure to look after them in their retirement, may be largely responsible for the story that a small-time Belfast builder, Freddie Scappaticci, was both the IRA's head of internal security and an agent for the British army.

Reuters

It's all nonsense, says Mr Scappaticci

Neither the army nor the IRA has denied the claim, although Sinn Fein, the IRA's political wing, has described it as "black propaganda". It was assumed that Mr Scappaticci had disappeared into the arms of Stakeknife's former handlers, but he turned up in his solicitor's office to tell the BBC that although he had been been involved with the Republican movement in the past, he had had nothing to do with it for 13 years, he denied the accusations and was mystified by the whole business.

The allegations against Mr Scappaticci imply that the agent of one arm of the security forces—the army—was murdering agents of the other bits. The IRA's internal security wing, which Mr Scappaticci is said to have run, was cheerfully known as the "nutting squad". "Nutting" is killing in IRA slang. Some of those despatched by the nutting squad are thought to have been working for MI5 and the police.

It has long been rumoured that the army had a top-level agent known as "Stakeknife". Mr Scappaticci is said to have offered his services in 1978, after he was beaten up by a senior IRA man, and to have been paid £80,000 ($130,000) a year.

The details of Mr Scappaticci's career that were reported this week are heavy on colour but light on provenance. He is said to have been involved in the deaths of 40 people. The story most damaging to the security forces, if true, is that when loyalist paramilitaries targeted Mr Scappaticci as a top IRA man, army intelligence agents tricked them instead into going after somebody else with an Italian name. Francisco Notarantonio, an elderly man who had not been involved with the IRA since the 1940s, was murdered in 1987.

What Stakeknife might have done for the security forces is unclear. According to one story, he warned them of a planned attack on Gibraltar, which allowed the army to intercept the terrorists and shoot dead the "Gibraltar Three" in 1988. But the only known investigation of his activities has been carried out by Sir John Stevens, London's police chief, who is currently looking into charges of collusion between the security forces and loyalist paramilitaries. Sir John has so far found no evidence to tie Stakeknife to either the Gibraltar bombings or the Notarantonio murder, but is understandably keen to talk to him.

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Britons in Saudi Arabia

The case weakens

May 15th 2003
From The Economist print edition

Do the Saudi Arabian bombings bring hope for British prisoners?

FOR some Britons, horror at this week's bombings in Saudi Arabia will have been mixed with a sense of vindication. The attacks—which bear all the hallmarks of an al-Qaeda operation—seem like further confirmation that the Saudi Arabian government made a mistake two years ago, when it convicted five Britons on charges of planting car bombs. Their sentences have not been revealed, but are believed to be between 18 years and death.

The case against the Britons seemed weak to begin with, and has weakened over time. Suggestions that the men were caught up in a turf war over the alcohol trade seem unlikely; although some were involved with illicit bars with names like Celtic Corner, they seem to have had no reason for pursuing a vendetta against the victims. It seems rather more likely that the Saudi authorities were trying to cover up the existence of home-grown terrorist cells. Confessions were almost certainly coerced, perhaps with the use of torture.

Now that the extent of terrorist activities in Saudi Arabia has been laid bare, will the prisoners be released? Not necessarily. The Saudi judicial system moves in a mysterious, not to say capricious manner. As Kate Allen, Amnesty International's UK director, says: “Given that the system is almost completely shrouded in secrecy, it is well-nigh impossible to tell whether the bombings in Riyadh are going to have any effect on the cases of those held for ‘alcohol turf wars'.”

Pressure from overseas might help clear the blockage. Jack Straw, the foreign secretary, who has adopted a softly-softly approach to the case, has lately been making more optimistic noises about securing their release. But the recent bombings may have worsened, not improved, his negotiating position. For a besieged Saudi regime, the most acceptable explanation for the latest attacks is that they stem from anger over the Iraq war.

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Rap music

Thug lite

May 15th 2003
From The Economist print edition

It isn't just political pressure that is turning rap from guns to peace

IT'S hard to know what is more ludicrous: a rapper in pursuit of respectability or a politician trying to connect with urban youth. Yet both are much in evidence at the moment. The nation's street poets have moved beyond their usual subject matter (flashy cars, loose women, the joys of marijuana) to grapple with the weighty issue of gun violence. In this, they have been abetted by the deeply square home secretary, David Blunkett, who allocated £70,000 to support a series of gigs in London last month. More are planned.

Rappers have long been associated with violence, though usually in a bad way. Earlier this year, Mr Blunkett and Kim Howells, the culture minister, accused them of glorifying the thug life and turning guns into fashion accessories. It wasn't clear whether the ministers were referring to American rappers or the milder British version. But the media lens soon focused on So Solid Crew, a popular British garage group whose members have shown a practical as well as a lyrical fondness for sidearms.

The artists initially defended themselves, arguing that their aggressive personae did not cause violent behaviour in others. Then, under continued pressure, they pulled an abrupt U-turn and began to preach against guns. Prominent among the new pacifists is Asher D, who was jailed last year for firearms possession, and Lisa Maffia, who hit the headlines last month following a shooting at a club at which she was due to appear.

Of course, if violent music does not cause violence, it is hard to see how conciliatory words might increase the peace. So what are the gangstas up to? As shrewd business folk, they may simply be trying to protect their product. Record sales have fallen steeply in the last year or so, in part because the music has turned rougher. Jason Sweetman, manager of Uptown Records in Soho, says that in his shop British garage singles used to sell 100 copies apiece; he now expects to move only ten or 20. At the same time, clubs and legitimate radio stations have become increasingly leery of a musical form that—however unfairly—has become associated with gangland killings.

This is a particular problem for mainstream groups such as So Solid Crew, which have achieved chart success in the past. As concert promoter Rob Hallett says, “If So Solid Crew hadn't been blighted with the gun thing, they'd be the new Spice Girls.” So it is hardly surprising that the group has been in the forefront of anti-violence initiatives.

Metaphorically speaking, though, they might have been better off sticking to their guns. The problem with taking a strong anti-violence line is that it can seem like pandering, and politically correct rappers are often left in the dust by less delicate souls. America furnishes a good example of what can go wrong. New York's rappers took a firm anti-violence stance in the late 1980s, but were soon overtaken—in sales and street cred—by the gun-toting lyricists of Los Angeles.

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Foreign nurses

Our country needs you

May 15th 2003 | JOHANNESBURG
From The Economist print edition

Britain's working-holidays plan will encourage nurses to leave South Africa

TALKS in South Africa this week between Jack Straw, the foreign secretary, and Thabo Mbeki, the South African president, were dominated by Zimbabwe, terrorism and tourism. But on top of these, Mr Straw's officials were keen to promote a new plan to make it easier for South Africans, especially skilled black ones, to visit Britain on working holidays. “We want to increase the numbers overall and broaden it: 98% of those who come are white,” said a British spokesman.

That sounds fair as well as politically correct but for one awkward fact: Alan Milburn, the health secretary, gave a pledge last year to the Royal College of Nurses that the National Health Service “would not actively recruit from developing countries”. The drain of clever, well-educated people from developing countries does more harm than aid money does good.

Making it easier to get working-holiday visas will both increase the flow of skilled South Africans to Britain and boost the numbers who stay. Although there is no official recruitment campaign in South Africa, it supplied around 1,500 of the 13,000 foreign-trained nurses who registered in Britain in the year to April. An influx of foreign nurses is the main reason why the government has already been able to surpass its target to boost the number of nurses working in the NHS. The number of foreign nurses working in Britain has doubled in the past three years, according to the Royal College of Nursing.

The flow of nurses from South Africa has risen eight-fold since 1991, says South Africa's nursing council, which verifies qualifications of emigrants. Well over half leave for Britain. South African nurses leave behind a huge public-health problem. The country is suffering from the world's worst epidemic of AIDS: about 11% of the population, 4.7m people, are infected with HIV. Tens of thousands of dying South Africans receive little more than home care by untrained relatives.

This week Manto Tshabalala Msimang, South Africa's health minister, said she would spend an extra 500m-1 billion rand (£42m-85m) a year to keep nurses in their jobs, especially in rural areas. That might stem the flow a little, and a plan in Britain to introduce mandatory HIV tests for foreign nurses might also deter some South Africans from seeking work. Still, more money for Britain's health service means fewer nurses for South Africa.

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Buying shops

Are you being served?

May 15th 2003
From The Economist print edition

Retailing takeovers are about financial engineering, not shopping

ON MAY 12th, the owners of Selfridges, a swanky London department store with branches in Manchester, accepted a £598m bid from Galen Weston, a Canadian retailer, though others may still enter the fray. The same day Debenhams, a bigger but more downmarket chain, announced a £1.5 billion bid from Permira, an investment fund. This follows recent takeovers of Allders and Harvey Nichols, a tussle for Safeway and failed bids for House of Fraser, Austin Reed and Moss Bros.

This shopping spree has little to do with buying potentially good businesses with duff management. Selfridges in particular is very well managed. Investors want shops because they think they can make a buck from taking these companies private, loading up their balance sheets with debt, and then (often) selling them off again.

The amount of money available for such deals from private equity investors has surged in recent years, thanks in part to their good track record in the 1990s. According to the European Venture Capital Association, some *euro*50 billion raised in Europe alone for private-equity funds is still to be invested. That is on top of the pots of money available to the likes of Mr Weston or Tom Hunter, a Scottish financier who also had a pop at Selfridges among others.

Retailers are particularly tempting targets. Until bid fever revived the sector, stockmarket investors tended to shun retailers because of fierce competition and worries that consumers were over-stretching themselves. At the same time, however, the value of their properties has been going up—by about 40% since 1995, its last official valuation, in Debenhams's case. Many of the shops being fought over are in Oxford Street or smart bits of central London, where values have surged.

Private investors want to load these businesses up with debt. This is cheap at the moment because interest rates are low. Stockmarket investors take fright at too much borrowing because it can make the business more volatile, and even bankrupt it if the economy sours. Private investors, who have nobody breathing down their neck, can live with volatility.

The financing trick is disarmingly simple. The private investor puts up some of the money himself; the rest is provided by a friendly bank manager. The bank is willing to lend the money because of the security provided by the valuable properties and because of fairly stable cashflows that pay the interest. In a few cases banks have provided 90% of the purchase price.

Investors can also pay off this debt by selling some or all of the portfolio of properties and then leasing them back again. In a previous deal, Permira bought Homebase, an upmarket DIY chain, from Sainsbury's, sold lots of assets, increased its debts and then sold it for a handsome profit to Great Universal Stores last year. “Private investors look like heroes, when all they've done is change the capital structure,” says a corporate financier at a bank that arranges many of these deals.

Doubtless there are more on the way. For one thing, despite the recent rally in their shares, many retailers still look cheap. For another, management is understandably keen; Debenhams's managers are warm to the idea of a deal with Permira. Going private avoids public scrutiny and accusations of fat-cat pay—the management of Debenhams, for one, will be kept on and should do nicely out of it.

Are bigger deals in the works? Boots, a big chain of chemists, is a possibility. Its stock price has been languishing, it has 1,400 shops, secure cashflows and a business that, as an analyst dryly puts it, “could be better managed”. It would cost more than £5 billion—steep, but not impossible.

How will it all end? Maybe everybody will live happily ever after. Or maybe, as in America's leveraged buyout boom in the 1980s, higher interest rates and recession will bring it all tumbling down.

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Investing

Cents and sensibility

May 15th 2003
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Lessons for fund managers from "Pride and Prejudice"

IT IS a truth universally acknowledged that investors can no longer expect rapid capital accumulation from stocks. Since interest rates are low and likely to stay that way, the conundrum is how to ensure a steady income from investments. Mrs Bennet was well acquainted with the problem.

Mrs Bennet, for those unfamiliar with Jane Austen, is the irritating but canny matriarch in "Pride and Prejudice", and has been used in a recent jolly paper* by Guy Monson, a fund manager at Sarasin, a fund-management group, to illustrate the similarities in the investment climate between the early 19th century and the beginning of the 21st. Mrs Bennet was in search of suitable husbands for her daughters. They had to have money as well as class. Interestingly, Mrs Bennet considered income more important than capital. "Mr Darcy soon drew attention of the room by his fine, tall person, handsome features, noble mien; and the report which was in circulation within five minutes of his entrance, of his having ten thousand a year." Government-bond yields, it is worth noting, were about the same as they are now.

Mrs Bennet, suggests Mr Monson, should have been a fund manager. Her focus on prospective son-in-laws' income anticipated the collapse in interest rates that continued for many years. They collapsed for a reason that looms once more: deflation. The price of bread in London in 1812 was 17 (old) pence per 4lb; by 1834 it was 8 pence. The price of coal delivered to Westminster School fell from 71 shillings per London chaldron (about 1.5 tonnes) in 1813, to 46 shillings in 1830.

Technological revolution and freer trade contributed to deflationary pressures then as now. Trade was growing rapidly at the time, as it had been in recent years. Technological change—inventions such as the Spinning Jenny increased productivity—and improved transportation—Britain's first railway, between Manchester and Liverpool, was opened in 1825—have modern parallels in the development of computer and internet technologies and the growth of air travel over the past ten years.

Thus, suggests Mr Monson, investors should concentrate on higher-yielding corporate bonds and equities with a high, progressive and reliable dividend policy. Mrs Bennet would no doubt have approved.

* "The Wisdom of Mrs Bennet", Sarasin Investment Comment, April 2003

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London schools

New labels

May 15th 2003
From The Economist print edition

London's secondary schools are shamefully bad. New plans offer hope

Get article background

THE biggest single blot on Britain's educational record is the dreadful state of secondary schools in inner London. Charles Clarke, the education secretary, is not exaggerating when he says that parents are “anguished and fearful” at the choices facing them. Nearly six out of ten inner-London schoolchildren fail to get five GCSE passes. In the worst 40 schools, fewer than a quarter manage even this undemanding target. No surprise, therefore, that some two-fifths of inner-London parents go elsewhere, either to the over-priced and over-subscribed private schools, or to state schools in the suburbs.

In response, the government is proposing a big stick, some gimmicks and a small carrot, all described as the biggest shake-up of education in the capital since 1945. The big stick is aimed at the 50 worst schools, which will be subject to much tougher monitoring, backed up with the threat to sack the head teachers, and if necessary closure. That is a blow against the educational establishment, which thinks that the only thing wrong with teachers is that they are underpaid. But to be really effective, the new schools must be a lot better than those they replace.

A big part of the government's plan is to break the monopoly of the local education authorities (LEAs) in running secondary schools in the capital. The centrepiece of the new plans will be some 30 City Academies. These independently run outfits, which mix private sponsorship with state funding, and are allowed to select a tenth of their intake, have worked quite well, mainly outside London. The government hopes that churches and schools from the fee-paying sector, such as North London Collegiate, a highly regarded girls' day school, will be among the sponsors of new City Academies. London's best state secondary school, which Mr Blair's children go to, is run by the Catholic Church.

The government also wants to attract good teachers to London, with a mixture of more flexible (meaning higher) pay, and subsidised mortgages for high-fliers. It promises more support for schools facing discipline problems.

There are three big problems with all this. The first is that City Academies have succeeded, so far, in isolation; critics say that they do well by creaming off the bright, hardworking and often middle-class pupils that help a school do well. Whether they can work the same magic in large numbers is an open question.

Another is central government interference. Planting dozens of new schools in central London in the coming five years will mean more, not less, involvement from the centre, at least in the short term. The education ministry's involvement in schools tends to generate huge quantities of paperwork, but much less in the way of real results. It also requires great optimism to believe that the central authorities will resist the urge to keep fiddling once the new system is set up.

The third and biggest question is whether all this will be enough to bring middle-class parents back into the state system. Many would be glad for their children to enrol in an inner London school that has been rescued from dreadfulness. But most will wait until others have made it happen.

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Asylum-seekers

A turtle disaster

May 15th 2003
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A new scheme to ship unwelcome visitors abroad

THIS April saw the forced repatriation of another 40 failed asylum-seekers. Officials said that the deportees, flown out of Heathrow airport under secure conditions, would be held at a special detention centre abroad. Some of them have lived in Britain for over a decade. But it is the British Chelonia Group (BCG), a charity based in Chippenham, Wiltshire, and not the British government that is sending these refugees to a centre in Europe. That is because the deportees are not people but red-eared terrapins.

The BCG is a charity dedicated to the “care and conservation of tortoises, terrapins and turtles”. Last year, charity workers accompanied some 200 terrapins from Britain to Europe's largest centre for the care of chelonids. It's in Tuscany.

Red-eared terrapins are, says BCG chairman Don Freeman, a problem. It all began in the late 1980s when the Teenage Mutant Ninja Turtle craze swept across the country and inspired interest in keeping red-eared terrapins as pets.

Unfortunately, as thousands of children were to discover to their horror, their cute 50p-piece-sized baby terrapins grew into large and truculent mutant teenagers. (Adults grow up to 40cm and have a nasty and powerful bite.) And, as parents were to discover to their horror, these voracious predators can also live for up to 40 years. Many are no longer wanted and have been abandoned in rivers and lakes, where they have caused havoc with native wildlife. The group wants to rescue such animals but Mr Freeman says he must first perfect his designs for a terrapin trap.

For now, though, the BCG is offering to take people's pets to a safe place where they can swim in their new lake, bask in the Italian sunshine and graze on fish pellets. Individuals are also “chipped”. Previous owners can then be informed when Leonardo, Michelangelo, Raphael or Donatello have shuffled off their mortal coil, joined the choir invisible and become ex-terrapins.

But since the terrapins actually originate from the swamps of Louisiana, why take them to Tuscany? The problem, jokes Mr Freeman, is that “the rotten Yanks won't have them back”. Imported terrapins could also bring diseases that would decimate the wild populations in America. Instead, then, they must go to this rescue home. And because BCG has sponsorship from Virgin airlines, the charity does not have to shell out to fly the terrapins to Italy. Cowabunga!

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Bagehot

Clare loses it

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With Clare Short's departure, Tony Blair's big tent looks a bit smaller

RESIGNATION often endows politicians with a potency they never had in the job. In a single speech, Geoffrey Howe, Margaret Thatcher's foreign secretary, metamorphosed from Denis Healey's "dead sheep" to the parliamentary executioner of one of Britain's most powerful prime ministers. Norman Lamont was not a distinguished chancellor, but his withering description of John Major's government as being "in office, but not in power" still stands as a memorable epitaph for Tory decline. When Robin Cook resigned as leader of the House of Commons over the war with Iraq, he found a dignity that few had suspected him of possessing. Nothing so became them in office as the leaving of it.

Not so Clare Short. In office, Ms Short was a thoroughly good thing. During her six years in the job, she managed to make the Department for International Development a model for other rich countries. Against the trend elsewhere, she fought with passion and success for a doubling in Britain's overseas aid budget (for which her main ally, Gordon Brown, the chancellor of the exchequer, also deserves credit). In making it her priority to help the poorest people in the poorest countries, she stood up to both bad governments and commercial interests. Although still a left-winger in most ways, she risked the ire of ideological fellow-travellers by zealously advocating trade liberalisation as the best way of combating poverty.

However, as a resigner, she has established a standard for cack-handedness that others will struggle to match. Ms Short, it will be recalled, first announced her intention to leave the government in an emotional radio interview after it had become clear that, "second resolution" or not, Tony Blair was going to war. But in spite of condemning the prime minister as "extraordinarily reckless", Ms Short stayed on. With a swelling rebellion among his MPs, it suited Mr Blair's purposes to keep her. By flattering her something rotten—the wretched of Iraq were depending on her—and promising that the UN would have a vital role in the country's post-war reconstruction, he persuaded Ms Short to remain at her post.

To many people, the decision to follow the path of duty must have seemed admirable, but among the rough types at Westminster, Ms Short made herself a laughing stock. Her old leftie chums accused her of betrayal, while loyalist MPs and government colleagues sneered at her "self-indulgence". Everyone assumed that at a moment of Mr Blair's choosing Ms Short would be dumped. A cabinet reshuffle in June, following hard on the heels of the euro announcement, has been widely expected.

Under the circumstances, the last few weeks of ministerial half-life must have been purgatory for Ms Short. Last week, when she failed to turn up at Westminster in time for a key vote on health-service reform and then played hooky from cabinet the next day, she appeared to be signalling that she had had enough. Reportedly, Mr Blair had suggested to cabinet colleagues that poor Clare had gone a little loopy. After all this, her resignation on Monday was about as shocking as a rainy start to the cricket season.

But even at the second attempt, Ms Short didn't get her resignation right. In the first place, although she must have felt she was jumping before being pushed, she was also saving Mr Blair the considerable embarrassment of sacking her. If she had played into his hands then by carrying on, she was surely doing the same by quitting now.

Still worse was the muddled account she gave of her reasons. Her complaint that she had not been adequately consulted over the draft UN resolution for the running of post-war Iraq was a little too self-regarding, while her compendium rant against the prime minister for his "presidential" style and centralisation of power was well over the top. Robin Cook, until his own resignation an enthusiastic Commons reformer, observed that he had never found Mr Blair to be anything other than accessible and properly respectful of his accountability to Parliament. That it is Mr Brown rather than Mr Blair who has

the final say over the euro hardly suggests over-weening prime ministerial power.

Which is not to say that the uneasiness on the Labour benches about the war, its increasingly messy aftermath and Mr Blair's relationship with President Bush is lessening. But unlike the clever and disciplined Mr Cook, Ms Short is simply too guileless to cause Number 10 much concern.

Presidential? Moi?

A more difficult question for Mr Blair is how far he now wants to go in excluding from his government those, like Ms Short, who are not wholehearted believers in the next stage of his “project”. Big tents are all very well, but long-serving prime ministers want cabinets that will do their bidding. It is a reflection not only of their own growing confidence, but also by the sense that time is limited and that too little has been achieved.

When Margaret Thatcher formed her first cabinet, “Thatcherites” were in the minority. Six years later, the point Mr Blair has now reached in his premiership, what ministers most feared was to be branded “not one of us”. Mrs Thatcher declared that she wanted people who would bring her solutions, not problems. A single-minded cabinet might, as she no doubt thought, have helped her get things done, but it also helped bring her down: by suppressing dissent, she forced underground the objections to the folly of the poll tax and growing tensions over Europe until they finally exploded.

With this government, everything comes down to the relationship between Mr Blair and Mr Brown. Mr Blair may be driven crazy by the incessant need to negotiate with Mr Brown, but he can console himself with the thought that the alternative might be more dangerous.

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Retailing

Trouble in store

May 15th 2003
From The Economist print edition

The scandal at Ahold is helping to uncover some of retailing's dodgier practices

WHEN accounting fraud at Ahold was revealed in February, the world's third-biggest retailer, based in the Netherlands, was swiftly dubbed “Europe's Enron”. As with Enron, it seems that the more facts come to light, the worse the problems look—and not just within the firm.

On May 8th, Ahold revealed the results of a forensic audit into US Foodservice, an American food-distribution subsidiary that it bought in 2000. They were awful. The fraud was far worse than originally announced. Ahold now says some $880m was falsely declared as pre-tax profits during 2000-02. The fraud followed a classic pattern, beginning relatively modestly with $110m in 2000, but escalating to $510m by last year, when the unit reported $850m of pre-tax profits to its parent.

Two managers in US Foodservice's marketing and purchasing team have been fired. But the pressure on Ahold has intensified. Its credit rating was cut on May 8th. Angry shareholders attended its annual meeting on May 13th to lambast management. With apparent reluctance, Ahold accepted the resignation of James Miller, chief executive of US Foodservice since 1997. Two other executives followed. Ahold says they were not implicated in the fraud. All in all, an interesting start for Anders Moberg, formerly of Ikea and Home Depot, who was appointed Ahold's new chief executive on May 2nd.

Few specific details have emerged about how the fraud was committed. Initially, Ahold said that there had been manipulation of “supplier rebates”. On May 8th it went further, attributing $700m of the fraud to “accrued vendor receivables” that had never actually existed and would therefore now have to be written off. At the annual meeting, Henny de Ruiter, chairman of Ahold's supervisory board, said that “promotional allowances” had been at the heart of the fraud.

None of this is likely to make much sense to anyone unfamiliar with the strange practices used by the world's big retailers to cut the prices they pay to their suppliers. Retailers and their suppliers are none too keen to discuss these practices, either. None of a group of big retailers and manufacturers approached by *The Economist* was willing to talk about the subject.

That is not wholly surprising. An official report on competition in British food and grocery retailing, published in 2000, noted a “general climate of apprehension” among suppliers terrified that, if they talked, their goods might no longer be wanted by angry buyers. Britain's competition authority is making a new inquiry into the retailers to examine whether the sale of the Safeway chain will hurt competition. A

central element of the inquiry is whether the demise of a competitor will increase the buying power of Britain's biggest retailers to unacceptable levels.

The fraud at US Foodservice is not an isolated incident. Last year Fleming, an American grocery chain, got into trouble after it first inflated the amounts it received from suppliers and then misled its auditors. Nash Finch, a wholesaler based in Minneapolis, is also under investigation for its use of promotional allowances. These practices are widespread in America, but also in Europe, and there is plenty of scope for mischief—and, thus, for more fraud to come to light, especially now that the authorities have been alerted.

Brought to book

Supplier rebates work as follows. The customer, usually a grocery chain, places an order for, say, washing powder, but negotiates a discount based on the amount ordered or on the time it takes to sell so many packets. When sales are totted up, the supplier can find itself returning cash to the retailer. Because accounts are often drawn up before cash actually changes hands, retailers sometimes book these sums in advance. If an expected level of sales fails to materialise, no rebate is due; the retailer's profits will have been falsely inflated.

In Britain, several big chains have an alternative tactic to squeeze money from suppliers. They use so-called “over-riders” to extract cash based on the annual amount of business they do with individual suppliers. At the start of the year they negotiate with the supplier to reach a contract. If they hit an agreed target of activity together, then the supplier has to give back a percentage of the money involved.

This is often done on a sliding scale, but fixed sums of up to 4% of sales can be extracted by some retailers. The gain to the retailer is booked in the next financial year, usually by deducting the sum from the first invoice sent by the supplier at the start of the year. Some retailers inflate the amount they deduct and then press the supplier to meet them in the middle. As one insider says, “there is often a bit of bouncing of suppliers towards the year end.”

The 2000 British report noted that unilateral deductions by retailers from money due hurt even the subsidiaries of large multinational manufacturers. Some retailers were brazen enough to demand ad hoc cash payments. Suppliers often felt powerless to resist. Small wonder that these practices are controversial.

They are not universal, either. In France, legislation was introduced in 1996 specifically to outlaw such tricks. French suppliers have to show any refunds directly on their bills and are protected from year-end haggling. In America, accounting guidelines introduced in January mean that it will be harder in future for retailers to give a false sense of their profits by manipulating payments from suppliers.

Industry observers say that rebates and discounts are just part of a bigger struggle in retailing. Paolo Venturi of A.T. Kearney, a consultancy, says that a range of discounts and incentive payments can be collectively defined as “trade spend”—the costs incurred by manufacturers in doing business with the retailers. He reckons such spending has risen sharply in recent years, its growth often outstripping the underlying revenue growth of the manufacturers. That suggests that the big retailers have more clout than before and can extract a greater share of the available profits.

Lack of transparency makes it difficult to say how much money changes hands, but the sums are huge. Mr Venturi reckons that a big manufacturing conglomerate might spend the equivalent of up to 25% of gross sales on “trade promotions” of one form or another. Measured from the other perspective, a typical big European retailer might extract the equivalent of 10% of its total revenues via trade spending. For an individual retailer that often means a sum measured in hundreds of millions. At an industry level billions are at stake.

This might explain both why Ahold's subsidiary was able to conduct fraud on such a large scale and why it took head office so long to rumble the scheme. Most retailers do what they can to exploit the rebate and discount systems without committing fraud. But Ahold's embarrassment shows how vulnerable global retailers are to dodgy dealings. Might there be other frauds that have so far gone undetected? Ahold is continuing to investigate its own operations in search of further problems. Others might be wondering whether they too have trouble in store.

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Media ownership rules

Too little, too late

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From The Economist print edition

New media-ownership rules in America may be too timid for the courts

AP

Nothing to do with Clear Channel?

WHEN a train carrying ammonia fertiliser derailed in Minot, North Dakota, last year, the police tried to get a local radio station to broadcast a warning about a toxic white cloud spilling from the wreckage. The station's failure to put out that warning, in a town in which all six radio outlets belong to one company (called Clear Channel), is now trumpeted as evidence of the perils of clearing America's thicket of rules that restrict the concentration of media ownership. Having relaxed the radio rules in 1996, say opponents, the government is about to repeat its mistake in newspaper and TV. Horribly, it was not just media diversity that suffered in Minot, critics imply. The ammonia cloud put hundreds of people in hospital. One died.

As the Federal Communications Commission (FCC), the industry's regulator, put a draft of the new rules before its five commissioners this week, opponents stepped up the fight. The FCC's two Democratic commissioners joined politicians of all hues to demand that the commission delay its vote, scheduled for June 2nd. Liberal media professors gave warning of the coming domination of the country's airwaves by giant, repressive conglomerates. Right-wing pundits forecast the further spread of the liberal-media conspiracy to poison American politics. All of which is rather puzzling, for the FCC's proposed changes seem mild to a fault.

It is unlikely that the FCC would have taken on its thankless task without persistent prodding from the courts, which have consistently ruled against the commission's ageing and seemingly arbitrary collection of rules in recent years. A rule preventing one firm from owning TV stations that serve over 35% of American households has been on the books since 1941, as have restrictions governing how many radio stations a firm can own in a single, local market. Other rules stop firms owning a newspaper and a radio or TV station in the same market (1975), a merger between any of the big four TV networks (1946), or one firm owning more than two TV stations in a single market (1964).

Michael Powell, the FCC's chairman, wants to relax these ownership caps a bit. The rule capping national TV ownership at 35% of households will rise to 45%, for instance. Some firms in some local markets will be able to own three TV stations instead of two. In most markets, firms will be allowed to own both a newspaper and a TV station, subject to certain restrictions. Mr Powell also wants to give these new rules some legal foundation. The judgments it makes on whether to allow mergers in local markets, for instance, will be built, in part, on readings the FCC takes from a new “diversity index”.

Whether the courts will be mollified by these efforts is, however, an open question. The FCC's own work points to a huge increase in the numbers of both media outlets and owners in America in recent decades, making a case for still bolder changes. Its study of ten local markets (from New York to Myrtle Beach, South Carolina) found that, between 1960 and 2000, the number of media outlets grew, on average, by nearly 200%. The number of owners, meanwhile, grew by 139%. The rapid spread of electronic media over the internet seems further to undermine the notion that the government ought to be in the business of ensuring media diversity. Should there be new demand for a particular sort of news, the astonishingly abundant supply of outlets and owners in America will surely rise to meet it.

Mr Powell's most recent efforts at deregulation ended in embarrassing failure, when a fellow Republican commissioner voted against his planned telecoms rules. This time, Mr Powell seems to have a solid

Republican majority, and may resist calls for delay. That may not provide much comfort to Clear Channel (which has also been accused of—and denies—organising pro-war rallies). Its investigation of the Minot incident found that the ammonia warning failed to get on the air not because the company's evil capitalists had gutted local staff and facilities, but because the police had not adjusted to a new, federally mandated warning system. Diversity, it seems, is no guarantor of the truth.

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The New York Times

Unfit to print

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Crisis management for a top media brand

QUALITY control problems can wreak havoc with any business, especially when a reputation for high quality is a crucial ingredient of its brand. Ask the *New York Times*, which is having to deal with its own version of Ford's dodgy Firestone tyres, and Coca-Cola's Belgian taste troubles.

The glitch in question is Jayson Blair, lately a fast-rising star on what is widely regarded, not least by itself, as the world's leading newspaper of record, exemplified by its slogan, “All the News That's Fit to Print”. Alas, it turns out that his college degree was bogus, and much of the acclaimed reporting he did, according to an internal *Times* inquiry, appears to have been invented or pasted together from the reporting of others.

To the credit of *Times* journalists, some had given early warning about Mr Blair to their superiors. But corporate whistle-blowing often fails to do the trick (remember Enron?). It certainly could not halt the rise of a young black journalist at a paper which may have allowed its celebration of “diversity and opportunity” to cloud its judgment.

How much damage Mr Blair has done to the newspaper's brand is unclear. In a four-page exposé that may have struck many outsiders as self-absorbed, detail after detail was disgorged. Mostly, his offences seemed to consist of what journalists call “colour”. However, the *Times* confirms that the Justice Department is taking an as yet unspecified interest. Rivals of the *Times* were withering. The upstart *New York Sun* disputed the claim by the *Times* that this was “a low point” in its 152-year history, offering in evidence its past celebration of the virtues of Stalin and the democratic principles of Fidel Castro.

This has come at a bad time for the *Times*. Its circulation fell by 5% in the six months to the end of March. It attributes this, mystifyingly, to “the difficult year-over-year comparison”. Yet in the same period, in New York's fiercely competitive newspaper market, the tiny *Sun* and the tabloid *New York Post*—each notably keener than the Times on the war in Iraq—have enjoyed strong growth.

In the past year of business scandals, the *Times* has not shied away from making tough calls, including criticising a lack of accountability of bosses for corporate failures. The executive editor, Howell Raines, won plaudits after being appointed two years ago and quickly guided the paper to seven Pulitzer Prizes. Yet Mr Raines's apparently close relationship with Mr Blair, and the paper's prolonged failure to unearth a pathological liar within its midst, has raised questions about what other “low points” might yet emerge. After Mr Blair's failings were made public, Arthur Sulzberger, publisher of the *Times*, said “let's not begin to demonise our executives—either the desk editors, or the executive editor or, dare I say, the publisher”. Other troubled corporate titans would no doubt conclude that the *Times* is finally getting religion.

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Beer in China

Masks off, down the hatch

May 15th 2003 | HONG KONG
From The Economist print edition

SARS or no SARS, the Chinese love beer and foreigners want to sell it to them

SOME economists are increasingly worried that the spread of SARS in China will scare off foreign investors. But for Interbrew, a big Belgian brewer, it is almost business as usual. Yes, SARS is giving him “sleepless nights”, says Wai Kee Tan, its boss in China, but the Chinese still drink an awful lot of beer—about twice as much as the Germans. Interbrew wants to share the fun. It is buying 70% of K.K. Brewery, the leading beer maker in Zhejiang Province, in China's Yangtze delta.

Interbrew already controls the biggest-selling brewery in the Pearl River delta. Other western brewers are getting in too. Anheuser-Busch, the world's largest, makes Budweiser in its own brewery in Wuhan, an inland city, and last year took a stake in Tsingtao, China's largest brewer. SABMiller, the world's second-largest brewer, has a joint venture with a Chinese firm.

All are thirsting for the second-largest market in the world (after America's) by volume. Because the average bottle of beer retails for about 1 yuan—barely a dime—the market is now worth only about $6 billion. But it is growing by a striking 6% a year.

However, it has problems. Some 400 domestic breweries are slugging it out in vicious price wars, and many are losing money. This is a legacy of the mid-1990s, when it became a matter of prestige for local party officials to have their own, local, brewery. At one point China had over 800 of them. The government is now encouraging consolidation, but even so, the top ten brands control less than 40% of the market. Mostly, local brands dominate in their area.

For foreigners, the current push is a second attempt. During the 1990s “beer bubble”, several of them, including Bass (now part of Interbrew), Fosters and Carlsberg, failed to break into the market. The chairman of the Swire Group, a conglomerate with roots in Hong Kong that knows China well, describes its venture into the Chinese beer market as its biggest recent embarrassment.

During that first investment binge, some westerners tried to go it alone and found that they could not compete against the locals' distribution networks. Others tried prematurely to push their premium brands into a market still dominated by cheap swill for poor folk. Interbrew, which calls itself “the world's local brewer”, is trying to do it differently this time. It will first push the successful Chinese brands it has just bought and then gradually introduce its luxury brands, such as Stella Artois and Beck's. Mr Tan worries at night that SARS might keep the Chinese away from crowded bars for a while. But he is sure they will return eventually.

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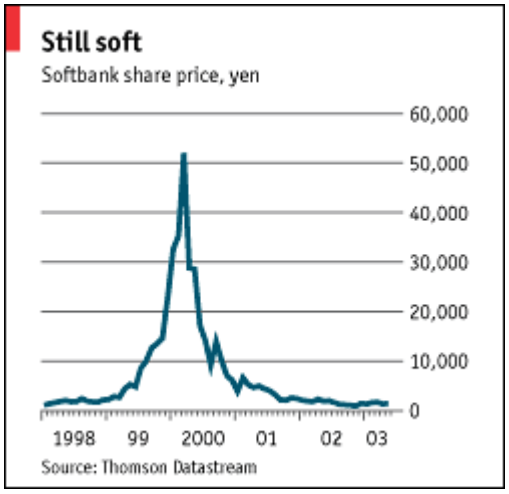
Softbank's woes

Hard times

May 15th 2003 | TOKYO
From The Economist print edition

Money is still flowing the wrong way through Softbank's broadband pipeline



LIKE many a *haiku*, Softbank's woes put a Japanese twist on a universal theme:

> The bandwidth broadens,
> Users sign up in millions;
> Where are the profits?

Softbank's boss, Masayoshi Son, has been hearing such sentiments a lot lately. On May 9th his collection of internet-related businesses posted a net loss of ¥100 billion ($820m) for the latest fiscal year, on top of a ¥89 billion loss the year before. Investors are especially worried by the huge cost of winning new subscribers to Softbank's broadband internet service. As Mr Son continues to unwind his battered internet empire, they can see more clearly just how far he is from profit.

When he cobbled most of Softbank together in the 1990s, Mr Son could not seem to make up his mind whether he was a venture capitalist, a deal-maker, or the head of a high-tech business group. Some observers likened Softbank and its affiliates to an internet-related *keiretsu*: a modern version of the loosely knit industrial groups that for decades drove Japan's rapid growth. Alas for Mr Son, Japan's internet boom did not last nearly as long as its industrial one. Its dotcom bubble burst, as others did, in 2000 and Mr Son has since been selling assets to repay bondholders and finance his broadband expansion.

Softbank's 49% stake in Aozora Bank (which it bought in 2000 after Japan's government nationalised the failed lender), will bring in ¥100 billion or so, if a proposed sale to Cerberus Partners, an American private-equity fund, goes through. Mr Son has also been gradually unloading his shares in Yahoo!, a big American internet portal. Softbank's remaining 4% stake in Yahoo! would fetch around ¥83 billion at the current share price. A 20% stake in UTStarcom, an American telecoms outfit that does much of its business in China, may be worth another ¥44 billion.

Although Softbank is carrying ¥341 billion of debt, much of that consists of bank loans, which tend to be rolled over in Japan. So by selling his remaining big equity stakes, Mr Son can raise more than enough cash to repay the ¥44 billion of bonds that mature in the next year, with plenty left over to pour into broadband expansion. Yet Softbank still seems worried about cash. It is toying with a plan to securitise the modems that it distributes to broadband customers. In effect, Softbank would sell future revenues from the modems to investors in exchange for cash now.

Why does Mr Son need so much money? Because it costs Softbank around ¥37,000 to sign up each new subscriber, including sales incentives and free installation. That compares with average annual revenue per user of only ¥4,000. But at least the huge outflow has quickly bought 2.6m broadband users. Now, NTT, Japan's main fixed-line carrier, is to try harder to expand its own broadband business, which will slow Softbank's broadband growth. Mr Son says he does not mind. He still expects 4m subscribers by March.

Besides, says Mr Son, anything that boosts broadband use in Japan will raise demand for online internet services. Softbank owns a ¥522 billion stake in Yahoo Japan, an internet portal, which would welcome more high-speed internet users. Although Softbank owns only 42% of Yahoo Japan, that stake is the only

really valuable remaining piece of Mr Son's business empire. The question is: if his costly broadband rollout puffs up his Yahoo Japan shares, and he sells them to pay his debts, what exactly will Mr Son have left?

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Mining in South Africa

Heavy pressure

May 15th 2003 | JOHANNESBURG
From The Economist print edition

From a royalties bill, the strong rand and lawsuits

In a hole

"MINING is a big, hairy, risky business," says Barry Davison, boss of Anglo Platinum, the world's biggest platinum miner. The South African is fond of risk. His office is in crime-ridden central Johannesburg; in his spare time he hunts bears, boars, deer, pheasant and wolves. And his firm is spending 20 billion-30 billion rand ($2.7 billion-4 billion) expanding production in South Africa.

Platinum prices have boomed for years and are likely stay high, partly because only two countries, South Africa and Russia, supply almost all the metal. The main risk in this investment comes from the government, which does not please Mr Davison at all. "We need certainty in mining, to know that this is still an attractive destination to invest in. There are unknown costs in South Africa, imposed by the black empowerment charter or by the imposition of too high royalties." His worries are echoed across the mining industry, as goldminers, coalminers and others address three related pressures: new laws, a strong currency and lawsuits. Are South African mining firms under unbearable strain?

The first is causing most debate and is shaking up the industry. New regulations for miners (and other firms) aim to create greater black ownership in a white-dominated business, and more revenue for the government's coffers. A mining charter requires that a minimum stake of 15% in all mining firms must be owned by black investors within five years, rising to 26% within a decade. Now companies are scrambling to meet these targets. Earlier this month, Harmony Gold Mining and black-owned African Rainbow Minerals said that they would merge to form the world's fifth-largest producer, HARMony, a company worth 20 billion rand. Observers say Harmony may have paid above market rates to acquire ARM's shares due to pressure for greater black involvement.

Last year's mining law in effect expropriated ownership of land from private miners. Now the government is introducing another bill to claim royalties from minerals dug out of that land. No mining company disputes the government's right to do this. But they warn that the extra tax—likely to take 2-8% of revenues, depending on the mineral—will discourage investment and may force closures and job losses. Earlier this month Harmony said that it might shed 10,000 jobs if conditions worsen. Some 500,000 people work in South Africa's mines. AngloGold's boss worries that South African mines are becoming less competitive.

No doubt much of this is just bleating by unhappy mining executives as they negotiate with the government to lower the royalty rates. Mr Davison, who is also president of the Chamber of Mines, says that talks with the Treasury about those rates are going well. Ironically, the companies likely to be worst hit by the new royalties are small, black-run mines that are barely profitable.

Matters have been made worse by the rand, which has strengthened from nearly 14 to the dollar 17 months ago to under eight to the dollar this week. All exporters are grumbling, but miners, despite efforts to hedge against currency swings, seem especially pained. This month Harmony reported a 49% drop in profits in the first three months of 2003; AngloGold says it expects earnings for the first half of this year to be sharply down too. Coal exporters are downcast, as they also face low global prices for the black stuff.

Mining share prices have tumbled. Along with manufacturers, miners want the central bank to cut interest rates fast, in an effort to weaken the rand.

A third threat is out of government hands. Mining firms, in particular, face several lawsuits, which South Africa's president, Thabo Mbeki, says he does not support. On May 19th, 60 firms face a first hearing in a case brought in New York by Edward Fagan, a lawyer noted for collecting big pay-outs from firms, who is suing for $100 billion for victims of apartheid.

The firms are accused of doing business with, and supporting, the white-minority South African government even after a United Nations ruling that apartheid was a crime against humanity. AngloAmerican and de Beers are being sued by Mr Fagan for $6.1 billion for exploiting workers during the apartheid years. Mr Fagan is also suing Gold Fields, another gold producer, for $7 billion. It allegedly exposed workers to uranium contamination. A big, hairy, risky business indeed.

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Energy

Twin powers

May 15th 2003 | ESSEN AND NIEDERAUSSEM
From The Economist print edition

Will the new bosses of German energy giants, RWE and E.ON, change strategy?

NOSES may be seriously out of joint at E.ON, a Dusseldorf-based utility. Its local rival RWE, based a mere 40km away in Essen, will soon finish testing its giant coal-fired electricity plant at Niederaussem, near Cologne. The state-of-the-art *euro*1.2 billion ($1.4 billion) plant boasts the world's biggest boiler, which will combine with the biggest-ever generator to produce up to 1,000MW of electricity, enough for 4.7m people—at the same time raising the efficiency of extracting energy from lignite to 43%, cutting carbon emissions from the dirty fuel by almost one-third.

E.ON's response? Until recently it would have made a big effort to trump RWE's technical feats. Under Ulrich Hartmann, its former boss, E.ON played tit-for-tat with RWE, whose boss, Dietmar Kuhnt, was not shy of a fight. Last year was typical, as the firms vied to launch the biggest eurobond issue, to announce the biggest new credit facility, and so on. Bankers were as amused by the jockeying as they were delighted by the fees it generated.

Corporate one-upmanship rarely benefits investors. Yet rivalry has pushed RWE and E.ON to the vanguard of European energy and, in RWE's case, to third in the global water industry, after Vivendi Environnement and Suez of France. In electricity only France's EdF is bigger than the German firms, with Enel of Italy further back.

Starting in the late 1990s, both firms have fundamentally reshaped themselves, thanks to a whirl of acquisitions and disposals that often seemed to owe more to mutual jealousy than to business logic. No sooner had RWE finalised its $4.6 billion purchase of American Water in January than E.ON closed an *euro*11.2 billion acquisition of Ruhrgas, Germany's dominant gas supplier. Since 2000, E.ON has spent *euro*38.7 billion on acquisitions, while raising *euro*44.4 billion from disposals.

RWE has not been far behind. Since 1999 it has transformed itself from a conglomerate into a utility group, with electricity and gas assets across Europe, as well as America's biggest water business. It boasts that half its 138,000 staff are located outside Germany and that roughly half its profits come from abroad. That has helped to protect it from the ravages of domestic competition: since the German electricity market was liberalised in 1998, wholesale prices there have fallen by more than half.

The uncanny parallels continue. Both firms have new chief executives, whose first task after reporting first quarter results this week will be to rethink strategies that have run out of steam. Curiously, both men are veterans of the oil industry, with years of service at Shell. Wulf Bernotat, E.ON's boss since May 1st, has announced a strategic review. Harry Roels became RWE's boss on March 1st, after a boardroom battle in which inside candidates lost out. He is likely to unveil a new strategy within a few months.

Each firm is likely to remain a “multi-utility”—offering customers a range of services from electricity to waste management. But the exact nature of the portfolio of businesses may alter, given the unhappiness of investors at the failure to exploit hoped-for “natural synergies” between, say, providing electricity and water.

“Synergies are not the raison d'être of the portfolio,” says Klaus Sturany, chief financial officer of RWE, reflecting the change of approach. Yes, there are some synergies between electricity and gas at a local level—delivering dual packages to consumers, for example—but not between energy and water. Yet water's better growth prospects arguably make it a good addition to the firm's more mature energy activities. Still, expect RWE's gas business, now a separate division, to be folded into the broader power division to try to eke out what synergies there are.

More strikingly, RWE and E.ON are unlikely to make further big acquisitions in the next year. RWE has debts of *euro*24 billion, affordable given its strong cashflow but large enough to preclude anything other than small deals to round out existing businesses. E.ON has a stronger balance sheet, but needs to make its existing assets perform better.

Finally, both firms must prepare a strategy to deal with the full liberalisation of Europe's energy market, due in 2007. Their strong market share in Germany—they control roughly half the electricity market, and E.ON has a virtual monopoly of gas—is a springboard from which they hope to compete head on with their bigger, state-owned rival, EdF.

They have already had a taste of how tough that battle may be. EnBW, a German electricity producer in which EdF owns a stake, led the collapse in electricity prices (and consequent fall in profits) that marked the first phase of market opening in Germany. Competitors say that was no coincidence. Yet arguably the only justification for allowing E.ON to buy Ruhrgas was the political one of establishing a robust German firm capable of standing up to Gaz de France, which is also state-owned and in which EdF has a stake. Rather than continuing to fight each other, E.ON and RWE are as likely in future to seek common purpose in battling the French, both at home and in France itself. Never let it be said that utilities are dull.

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Face value

The Cain and Abel problem

May 15th 2003
From The Economist print edition

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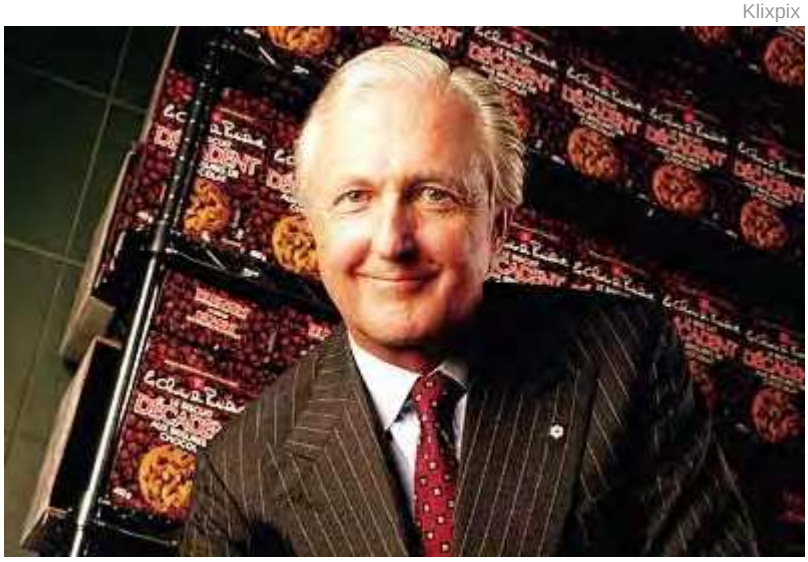

Galen Weston is proof that family squabbles are not always fatal for family businesses

Get article background

LIKE royals, family businesses have a special mystique. Galen Weston, a Canadian retailing billionaire whose bid for Selfridges, a posh London department-store group, was accepted this week (though others may still try to top it), is no Prince Charles. But he played polo with the prince in his youth, went to the Queen Mother's 100th birthday party and owns a grand gated community in Florida called (what else?) Windsor. Successful family businesses have a strength that ordinary quoted companies often lack. But success—for family businesses, as for monarchies—means getting on with your relatives, or at any rate reaching an accommodation with them. Rows can destroy not just the family, but the business as well.

The Weston family has succeeded mainly through skilful use of geography. Its founding father, George Weston, was the son of a cockney who settled in Canada. George's son, Garfield, collected companies like stamps and created a multinational food business, with outposts in Britain, America and Australia. After a feud in 1972, two of Garfield's sons, Garry and Galen, decided to split the empire on geographical lines: a brilliantly pragmatic solution, from which other squabbling families might learn.

Garry, who died last year, took over Associated British Foods, a firm that produces such delights of British gastronomy as Sunblest sliced bread and Wagon Wheels biscuits. A modest man with an accountant's mentality, he also owned Fortnum & Mason, the swankiest food shop in London. Meanwhile Galen ran the family's businesses in Ireland (where he met his wife, a formidable lady who did a stint as lieutenant-governor of Ontario). He also reorganised Weston, the family business in Canada, and Loblaws, a lacklustre retailer, and expanded in America by acquiring Bestfoods Baking. Although he sits on Fortnum & Mason's board, his bid for Selfridges is his first big foray into Britain.

The Weston family empire is more typical of business organisations around the world than are, say, General Electric or BP. In spite of the vast number of news pages devoted to publicly quoted firms in which families play no part, most of the world's businesses are either family-owned or family-dominated. One study in the mid-1990s estimated that more than 90% of all enterprises in America were family-owned; to some degree, about one-third of *Fortune* 500 companies are family firms.

Such businesses work marvellously if the family gets along, or if it finds ways to defuse rows early. John Davis, head of Harvard's Families in Business programme, is writing a book on successful dynasties. He has come across a small Dutch distillery, De Kuyper, that is run by the tenth generation of the family that founded it in 1695. The Rothschilds, a banking dynasty for two centuries, have sometimes demonstrated that family rows can be as creative as family harmony: in the 1980s Jacob Rothschild broke away from the family empire and created a clutch of successful financial companies of his own.

But, on the whole, nothing is as destructive as a family business bust-up. In a classic article on the subject in the *Harvard Business Review* in 1971, Harry Levinson noted:

> "The most successful executives are often men who have built their own companies. Ironically, their very success frequently brings to them and members of their families personal problems of an intensity rarely encountered by professional managers. And these problems make family businesses possibly the most difficult to operate."

Few rows are as lethal as that at Gucci, a fashion business, where Patrizia Reggiani was jailed in 1998 for murdering her ex-husband, Gucci's former chief executive, Maurizio Gucci. But Asia, a bastion of family empires, has some terrifying examples of the destructive power of a family feud. Hyundai, a South Korean carmaker, was torn apart when the founder died and two sons quarrelled. Y.C. Wang, patriarch of Formosa Plastics, kicked his son, Winston, out of the family firm after he had a highly publicised extra-marital affair, and turned to professional managers instead.

Some of Canada's other corporate families are hot on hate. Samuel Bronfman's drinks business passed to one of his grandsons, Edgar, who bought Universal Studios, merged the business with Vivendi and sold off Sam's empire. The loss of most of the family fortune has infuriated the founder's other children and grandchildren. The McCain brothers of New Brunswick, owners of the world's largest frozen potato-chip business, no longer speak to each other, even though their neighbouring houses overlook a potato-processing plant on the St John River.

My brother's shareholder

Some family rows are about corporate strategy; many are about the reluctance of a founder to make way for an heir. An increasingly common problem, says Tony Bogod, head of family business at BDOStoy Hayward, an accounting firm, is tension between the minority of family members who work in the firm and the larger number that own its shares. The shareholders grumble that their dividends are measly and their shares unmarketable, large though their wealth looks on paper.

A classic version of this row is now playing in Chicago, where the Pritzker family, owners of Hyatt Hotels for four generations, is feuding magnificently. Liesel Pritzker, once a child film star and now an angry 18-year-old, is suing her father, uncle, cousins and half-siblings for money she says they stripped from her family trust funds. Other family members have also been demanding more money from the business.

The answer, says Mr Bogod, is to draw up a family charter or constitution—a document in which the family agrees the principles on which the business will be run. A good idea if you can't get geography to keep your relatives out of your hair, as the Westons seem so successfully to have done.

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Award

May 15th 2003
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Frances Cairncross, our management editor, has won the Institute of Internal Auditors' annual award for business and management journalism.

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Counterfeiting

Imitating property is theft

May 15th 2003 | BEIJING, LONDON AND NEW YORK
From The Economist print edition

AP

Counterfeiting is on the increase. Companies ignore it at their peril

THIS week, the American government unveiled a new $20 bill. Designed to stay one step ahead of counterfeiters, its most notable feature is its colour: the stately green and black of the old bills has been joined by sprightly peach and blue. Alone, this might pose little deterrent to America's digital forgers. Armed with PCs, scanners and laser printers, they account for roughly 40% of all counterfeit currency confiscated in America. Other features, however, will make copying far more difficult than it was: the new bill has enhanced security devices—including a watermark, security thread and special inks.

Thomas Ferguson, director of the Treasury's bureau of engraving and printing, says that keeping counterfeits at bay has as much to do with strict law enforcement and public co-operation as it does with high technology. In any case, it is a combination that seems to be working: fewer than 0.02% of all dollar bills turn out to be fake. Such quality control is something that other industries that are newly at the sharp end of the forgers' skill can only dream of.

To most people, counterfeiting means forged currency first and foremost. But counterfeiters are copying an ever widening range of products. For some time they have been churning out imitation designer fashion, software and CDs. Now they are copying medicines, mobile phones, food and drink, car parts and even tobacco.

New technology has broadened the range of goods that are vulnerable to copying. It has dramatically improved their quality, as well as lowering their cost of production. Where once counterfeits were cheap and shoddy imitations of the real thing, today their packaging and contents (especially for digital products such as software, music CDs and film DVDs) often render them almost indistinguishable from the genuine article.

The globalisation of deceit

A counterfeit, on a strict definition, is something that is forged, copied or imitated without the perpetrator having the right to do it, and with the purpose of deceiving or defrauding. Such rights are legally enshrined in patents (linked with inventions), copyright (which covers literary, musical and artistic works,

and software), trademarks (which include words, pictures and symbols), industrial designs and other forms of intellectual-property protection.

Counterfeits come in many shapes and sizes. Mark Turnage, co-author of a new book* on counterfeiting, groups them into four broad categories, according to the quality of the product and the level of deception. They range from the cheap look-alike Rolex, bought knowingly by a happy customer, to the counterfeit, sub-standard brakes on an unsuspecting driver's car.

The international capital of counterfeiting is undoubtedly China. At least $16 billion-worth of goods sold each year inside the country are counterfeit, according to one conservative estimate. Procter & Gamble reckons that 10-15% of its revenues in China are lost each year to counterfeit products. The International Intellectual Property Alliance claims that 90% of musical recordings sold in the country are pirated.

Most of China's counterfeit bounty stays inside the country, but rising quantities are now destined for foreign markets—as recent customs seizures in America show (see chart). This international trade depends on sophisticated distribution networks. Increasingly run by organised-crime syndicates, these use many of the same routes that have been established for trade in narcotics.

China is by no means the only big exporter of counterfeits. In its annual “Special 301” review, published earlier this month, the office of the US trade representative (USTR) fingered more than 30 countries as counterfeiting and piracy hotspots. Ukraine, for example, is awash in bootleg optical discs; Russia is running on counterfeit software; while Paraguay is rolling in imitation cigarettes. The USTR reckons that American industries lose $200 billion-250 billion a year to counterfeiting.

Nor is such activity restricted to poor places. Milan is a leading producer of counterfeit luxury goods and Florida is an international haven for fake aircraft parts. The Counterfeiting Intelligence Bureau (CIB), part of the International Chamber of Commerce, estimates that 7-9% of all world trade is in counterfeits, their path smoothed by the opening up of markets. Given the clandestine nature of the business, such estimates can be no more than educated guesses. But there is no doubt that counterfeiting, like manufacturing, has gone global.

Fast-moving fakes

Counterfeiting is an age-old pursuit. From ancient times people have palmed off fake valuables as the real thing. In the 17th century, Domingo Navarette, a Spanish priest, complained that “the Chinese are very ingenious at imitation. They have imitated to perfection whatsoever they have seen brought out of Europe.”

The past quarter of a century has, however, witnessed a remarkable rise in the counterfeiting of consumer products. Ian Lancaster of Reconnaissance International, an anti-counterfeiting research group, points to several forces behind this. Since the 1970s, technological advances have taken much of the skill out of manufacturing. This has allowed big business to move its manufacturing base to poor countries to take advantage of low labour costs. Unfortunately, many of these businesses paid insufficient attention to the sort of intellectual-property rights (IPR) on offer in such places. Now they are paying the price.

This migration coincided with the growing popularity (and rocketing value) of brands. Through ingenious marketing, a simple designer label can turn a comfy $10 T-shirt into a $100 object of aspiration. So much of a product's worth is now tied up in its brand and intellectual property, rather than its material constituents, that it becomes easy prey for counterfeiters who can exploit consumers' expectations of quality and service without the cost of having to fulfil them (see chart).

Although multinational firms are the loudest complainers about counterfeiting, they are not the only ones to suffer. Because counterfeiters copy popular brands, local firms in counterfeiting hotspots can also be losers. In Thailand, domestic firms such as

GMM Grammy, which produces movies and music, and Jim Thompson, an upmarket silk producer, have seen their Thai sales falter because of counterfeiting. The state tobacco monopoly has launched a vigorous campaign to stop counterfeit versions of its Krongthip cigarettes flooding in from abroad.

Counterfeiting is as diverse as any legal business, ranging from back-street sweatshops to full-scale factories. Counterfeiters often get their goods by bribing employees in a company with a valuable brand to hand over manufacturing moulds or master discs for them to copy. One of the most infuriating problems for brand owners is when their licensed suppliers and manufacturers "over-run" production lines without permission and then sell the extra goods on the side.

Distribution networks can be as simple as a stall in the street, or a shop on the other side of the world. The internet has been a boon to counterfeiters, giving them detailed information about which goods to copy and allowing them to link consumers and suppliers with ease and relative anonymity. Peter Lowe, head of the CIB, reckons that some $25 billion-worth of counterfeit goods are traded each year over the internet.

The complex distribution network required by the larger counterfeiters has attracted organised crime. Interpol is well aware of the connection; last year it established a special working group to improve co-ordination of international action against counterfeiters. Of growing concern to authorities, however, is evidence that terrorists too are in on the act. The 1993 bombing of the World Trade Centre was financed, in part, by sales of counterfeit T-shirts in New York; and the CIB maintains that the IRA has funded some of its activities in recent years through video piracy. The World Customs Organisation is now working on new ways of monitoring and controlling international supply chains. Its explicit aim is to clamp down on smuggling by terrorists; but a happy side-effect may be to cut back on counterfeits too.

The cost of turning a blind eye

Counterfeiting is not a victimless crime. For a start, legitimate businesses lose sales because of competition from counterfeiters. If their brand loses value (because it is seen as less exclusive or is confused with shoddy imitations), this poses a long-term threat to profitability. In addition, firms have to bear the cost of anti-counterfeiting measures. Procter & Gamble reckons that it spends $3m a year fighting the copycats.

Another headache is the prospect of legal liability. Last year, Serono, a Swiss biotechnology company, settled a case with two American customers who had sued the firm (and assorted distributors) after taking a fake version of its body-boosting drug Serostim. The plaintiffs claimed that the company should have foreseen the possibility of counterfeits entering the distribution chain and should have taken suitable precautions.

A study in 2000 by the Centre for Economics and Business Research estimated that the counterfeiting of clothing, cosmetics, toys, sports equipment and pharmaceuticals within the European Union cost the region 17,120 jobs, and reduced GDP by *euro*8 billion ($7.4 billion) a year. As counterfeiters rarely pay duties or taxes, governments lose further revenue. And countries with endemic counterfeiting may sacrifice foreign investment too. Sony, for example, has toned down its music operations in Hungary because of counterfeiting. There is, however, little sign that multinationals are avoiding China: quite the opposite.

Given the costs, big business is keen that consumers should feel as strongly about counterfeiting as it does. But most customers, in the developed world at any rate, are relatively unconcerned. Some argue that counterfeiting benefits consumers, particularly in developing countries, by giving them access to lower-price goods, such as software, that they might not otherwise be able to afford. And they claim that counterfeits occasionally push brand-holders into innovating in their customers' interests. Yamaha, for example, has decided to beat China's counterfeiters at their own game by introducing a new model of motorcycle at roughly the same price as the fake Yamahas on the streets.

Nevertheless, the costs of counterfeiting far outweigh the benefits. The World Health Organisation reckons that 5-7% of pharmaceuticals worldwide may be counterfeit—with too few active ingredients, too

many contaminants, fake labels or recycled packaging that covers up expiry dates. The problem is most acute in developing countries. Three years ago, a survey of shops selling artesunate, an anti-malarial drug, in Cambodia, Laos and Thailand, found that more than a third of the samples analysed had no artesunate in them at all. Even in America, counterfeit medicines are not unknown. Last year, the Food and Drug Administration (FDA) launched some 30 investigations into cases of pharmaceutical counterfeiting, involving such popular brands as Combivir (against HIV) and Procrit (for anaemia).

At least as hazardous is the trade in counterfeit car parts, which may account for as much as 10% of the spare parts sold in the EU, according to a 1999 study. Even more worrying is the thriving trade in reconditioned aircraft components, passed off as genuine parts along with fake certificates of authentication. Last year, police raided three aviation-parts manufacturers in Rome, seizing more than $2m-worth of used parts—modified and repackaged to look as good as new.

Dodgy aircraft parts kill. In 1989, a plane belonging to Partnair, a Norwegian charter airline, crashed when its tail assembly fell off because of substandard counterfeit bolts holding it to the rest of the body. The CIB believes that the November 2001 crash of an American Airlines flight over New York may have been caused by the failure of counterfeit parts.

How not to mistake a fake

Few big companies are unaffected by counterfeiting somewhere in the world. As Tony Gurka, managing director of Commercial Trademark Services in Hong Kong, notes, “you get corporations saying they don't have problems. Well if they don't, either they have a lousy product or it's being copied so well they don't know about it.”

One tack that companies increasingly take is to load their vulnerable products with anti-counterfeiting features. Some of these, borrowed from pioneering security devices developed for use on dollar bills and the like, are clearly visible and are intended to help consumers distinguish fakes from genuine goods. One approach, used by Telesense in Beijing, is to label each item on sale with a unique 16- to 21-digit number. Consumers can confirm that the item is genuine by calling the company. Telesense reckons it has 8 billion numbers in its database and on products throughout China. But such overt anti-counterfeiting features depend on consumers caring enough to make a call. Other devices, such as holograms, are themselves prone to counterfeiting.

AP

Bags of tricks

Companies also use covert features, primarily to help them trace their products through the supply chain and to distinguish genuine articles from fakes, especially should they need to take the copycats to court. Molecular tags (such as DNA) are being used in products or on packaging to mark them in such a way that special assays can distinguish the real thing. And there is a raft of encryption methods to stall, if not stymie, would-be software and digital media pirates.

A number of firms have sprung up to provide authenticating technologies. Pira International, a trade organisation, reckons that the markets for these technologies will be growing by more than 10% a year by 2005. But many companies still balk at the cost of some of the more effective technologies, especially in today's economic climate.

Bill Thompson, the Shanghai-based managing director of Pinkertons, a private investigation firm, claims that the key to fighting counterfeiting is the four “Es”: enforcement, education, external pressure, and economic growth. Once firms get a hint that counterfeits are circulating in a particular market—from, say, unexpected fluctuations in sales or angry consumers—many employ the likes of Mr Thompson to watch the market, collect samples, and co-ordinate raids with the local police.

But enforcement in many countries is uneven. To begin with, police or customs officers are often more interested in fighting what they consider to be more serious offences, such as homicide or drug smuggling. There is also a problem of job protection: in many poor places, counterfeiting is the biggest business in town, and local police would rather not be responsible for putting local people, and even their own relatives, out of work.

Two years ago, Russell Lerner, who works for Pinkertons in Bangkok, went on a raid in Photharam district in central Thailand to clear out counterfeiters making stuffed knock-offs of Mickey Mouse and other famous characters. Over 1,000 people turned out to block the raid. It eventually took government intervention to confiscate the furry contraband and shut down the sweatshops. Today, however, Photharam is back in business, “as if nothing ever happened”, says Mr Lerner.

Home-grown remedies

Besides such problems of enforcement, laws on IPR in many countries are still not up to scratch. By 2006, all members of the World Trade Organisation, save the poorest, are supposed to have implemented TRIPS, an international treaty on IPR that lays down basic rules for protection and enforcement. Some countries, notably China, have tidied up their legal codes so that companies can, at least on paper, protect their intellectual-property assets. But, in practice, cases are often hard to bring to trial, and courts are reluctant to prosecute and impose criminal penalties. In America, convicted counterfeiters face fines of up to $2m and 10 years in prison for a first offence. In China, counterfeiters can still get away with a $1,000 fine, which even there provides little deterrence.

In Europe, the European Commission is working on new regulations to beef up customs action against counterfeits. It has proposed new rules to harmonise member states' legislation on IPR enforcement. This is particularly important as the EU prepares to embrace new members, such as Poland, where counterfeiting is a serious problem.

Increasingly, companies are joining together in industry or regional coalitions to deal with the issue. One of the busiest groups is called the Quality Brands Protection Committee. In China, it collects data on the scale of counterfeiting, and lobbies the government for better protection. It also educates police and customs officers on effective enforcement.

In the end, though, growth and home-grown invention are the most effective remedies to counterfeiting. In the 1960s, Japan was a hotspot for copying; in the 1970s, that dubious distinction passed to Hong Kong; in the 1980s, it was Taiwan's and South Korea's turn in the spotlight; and today it is China's. As each of the pioneer countries has developed its own industry, it has introduced laws and penalties to clamp down on counterfeiting. China will, at some point, follow the same route. But no amount of effort will ever completely eradicate the copycats. For as long as there is consumer demand, companies will find that imitation is the severest form of flattery.

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*Counterfeiting Exposed: How to Protect Your Brand and Market Share, by David M. Hopkins, Lewis T. Kontnik and Mark Turnage. John Wiley and Sons, New Jersey, 2003

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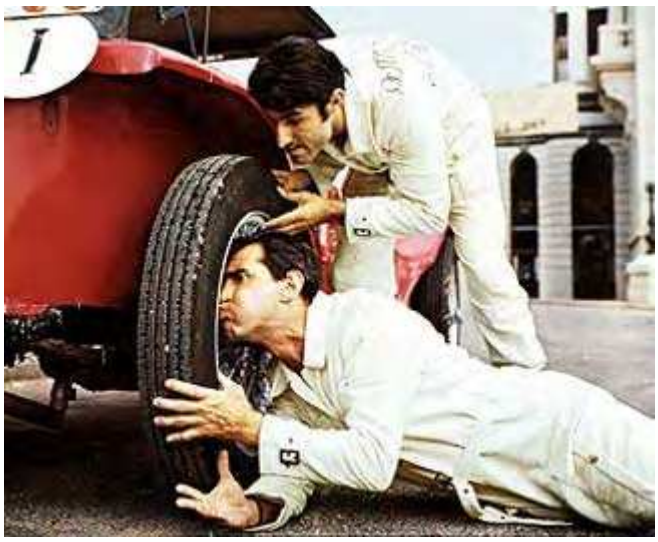
About sponsorship

Deflation

Hear that hissing sound?

May 15th 2003
From The Economist print edition

Ronald Grant



If inflation falls much further, central bankers will need to delve deeper into their monetary tool-kits

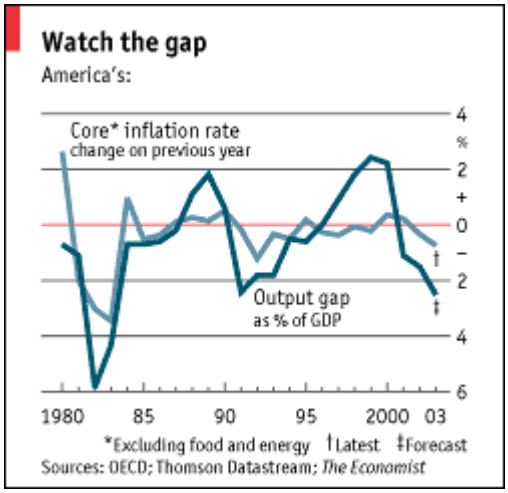
FOR three decades central bankers have struggled to push inflation lower, but some are now starting to wonder whether falling prices might be the bigger threat today. Last week America's Federal Reserve said that a further fall in inflation would be unwelcome. Meanwhile, the European Central Bank (ECB) lifted the floor of its inflation target. In other words, both central banks were admitting that inflation can be too low.

Japan has been suffering from deflation (a fall in the general price level) since the mid-1990s, but now there are fears that the disease could spread to America and Europe. America's core rate of consumer-price inflation (excluding food and energy) has fallen from 2.8% in late 2001 to 1.7% in March, its lowest since 1966. The euro area's core inflation rate has fallen from 2.6% to 1.7% in the past 12 months.

Thanks to overinvestment during the bubble years of the late 1990s and to current sluggish demand, the world is awash with excess capacity in industries from telecoms and airlines to banking and cars, putting downward pressure on prices. Even if a recession is avoided, economic growth looks likely to remain below trend this year almost everywhere; so output gaps (the difference between countries' actual and potential GDP) will widen. The euro area's feeble start to the year (the GDPs of both Germany and Italy shrank in the first quarter) suggests that the single-currency zone will see an even bigger increase in its output gap than America has. Even if growth returns to trend next year, the gaps will remain large.

Historically there has been a close relationship between the size of the output gap and the direction of change in inflation (see chart). When the output gap is negative (actual output is below potential), as at present, inflation usually falls. With inflation already low, a further two years of decline could easily end in deflation. Economists at Dresdner Kleinwort Wasserstein forecast a core inflation rate of just above 1% in America at the end of next year, and of only 0.2% in the euro area. They expect that by then consumer prices will be falling in both Germany and France.

The fact that neither the Fed nor the ECB cut interest rates at their policy meetings last week suggests that they are more sanguine about the risk of deflation. Wim Duisenberg, the ECB's president, said that he did not expect headline inflation to fall below 2% until the end of this year. Yet several private-sector forecasters reckon that the stronger euro and higher unemployment could reduce inflation to close to 1% by early next year. That would be well below the ECB's newly clarified inflation goal of less than, but close to, 2%. The ECB's previous target was “less than 2%”, but its new goal is still too low. Most central banks have targets with mid-points of 2.5%.



Deflation is not always bad. If caused by rapid productivity growth, as in the late 19th century, it can go hand in hand with robust growth. But if prices are falling because of a slump in demand, deflation can be dangerous. Today the world exhibits both sorts of deflation, but the vast amount of excess capacity suggest that most of it is the bad sort.

Deflation is particularly harmful when an economy has lots of debt, because falling prices swell the real debt burden. This can lead to a vicious circle: as heavily indebted firms are forced to reduce costs, jobs and spending are cut across the economy, pushing prices lower still. In both America and the euro area, total private-sector debt today is larger as a share of GDP than it was when deflation last haunted the world in the 1930s—though not as high as in Japan a decade ago.

The biggest economic danger is that, because nominal interest rates cannot go below zero, deflation makes negative real interest rates unattainable. But then these may be needed to drag an economy out of recession. Last year a study by economists at the Fed of Japan's slide into deflation concluded that monetary policy was not too tight in the early 1990s, given the outlook at the time for growth and inflation. But those forecasts proved too optimistic, and by then it was too late to act. The lesson is that as interest rates and inflation move closer to zero, central banks need to cut interest rates more forcefully than would normally be called for by forecasts of growth and inflation. This justifies the Fed's aggressive easing over the past two years. The ECB's recent behaviour suggests that it has not read the Fed study.

Germany in a bind

American interest rates (1.25%) are lower than the euro area's (2.5%), which might suggest the Fed is running out of ammunition. But the weaker dollar will help to fend off deflation. Indeed, Germany looks more susceptible to deflation than America. Germany cannot cut interest rates (which are set by the ECB) or loosen fiscal policy (which is constrained by the euro area's stability and growth pact); the euro is rising; its banks are in much worse shape than America's are; and German households and companies have even bigger combined debts than do their American counterparts.

Both the Fed and the ECB need to cut interest rates further if they are to be sure of avoiding deflation. But what if deflation takes hold and interest rates hit zero? Late last year, Ben Bernanke, a governor of the Fed, flagged a range of alternative measures that could be used:

• A central bank can reduce long-term interest rates. One way would be to announce that it will hold short-term rates at zero for an extended period. Long-term rates, which depend upon expected future short-term rates, would then fall.

• A more effective way to reduce long-term rates is for the central bank to buy government bonds. This is Mr Bernanke's preferred cure, but it has not stopped deflation in Japan, where long-term bond yields are 0.6%. Mr Bernanke blames Japan's defective banking system and a lack of determination by policymakers to fight deflation. There is some truth in this, but another reason why the policy has failed to boost spending is that overindebted households and firms prefer to save and repay debt. Given the huge excesses left after America's bubble, the same might happen in the United States.

• As well as government bonds, a central bank could buy private securities to pump in more liquidity. This might require a change in the law in some countries.

• Foreign-exchange intervention, to push down a currency, could help to boost output and raise import

prices. The most striking example of this was the devaluation of the dollar in 1933-34, which helped to end deflation. This would work for a single country, but it is not an answer to global deflation: not every country can devalue. A falling dollar will reduce the risk of deflation in America, but push inflation lower in the euro area and Japan.

• Last but not least, a central bank can print money to finance tax cuts or higher public spending. This is the surest method of halting deflation, but it is not foolproof. Tax cuts might be saved, not spent, by debt-ridden consumers, so an increase in public spending could be more effective. But, as in Japan, there is then a risk that money is channelled into politically favoured projects with low returns.

In a serious bout of deflation, a central bank acting alone may fail to halt deflation, but if a central bank and government act jointly they will surely succeed. However, a money-financed fiscal stimulus requires co-ordination between the government and the central bank—something that newly independent central banks find hard to do. This has been a big stumbling-block in Japan; such co-ordination would be even harder to achieve in the euro area, where there is the extra complication of the stability and growth pact.

Mr Bernanke believes that, if a central bank injects enough money, it can always reverse deflation. Implicit in this is the view that Japan's persistent deflation reflects the Bank of Japan's incompetence, and that the Fed would do a better job. Is this right? Policy errors are partly to blame for Japan's plight, but the awkward fact is that post-bubble economies tend to be prone to deflation. The Fed may find it harder than it thinks to escape the deflation monster. As for the ECB, its recent behaviour gives little cause for confidence that it would act swiftly.

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Trade

The GM gamble

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The United States challenges Europe's block on genetically modified food

Get article background

AMERICA has made no secret of its growing annoyance with the European Union's attitude to genetically modified (GM) crops. With many European consumers revolted by the thought of “Frankenstein foods”, the EU has refused to approve any GM products since 1998. The Americans consider this moratorium illegal under the rules of the World Trade Organisation (WTO); for months they have been threatening to bring a formal WTO complaint. Even so, the launch of such a complaint on May 13th came as a surprise, not least because of the risks it creates for already fragile world trade talks.

The WTO's rules allow countries to regulate imports of crops and foods on health or environmental grounds. However, any restraints must be based on “sufficient scientific evidence”, and there must be no “undue delay”. America contends that Europe's go-slow does not meet these conditions. Indeed, its trade wallahs point out that EU officials have themselves called the moratorium “illegal and unjustified”.

The EU's inaction is costing American farmers, the world's biggest planters of GM crops, several hundred million dollars' worth of potential exports to Europe a year. The Americans also worry that the anti-GM stance is contagious. Last year, despite widespread starvation, several southern African countries refused American food aid for fear that GM crops would infiltrate their own crops and jeopardise exports to Europe. China also invokes Europe's attitude to justify its go-slow on commercialising new GM crops.

Nor is America alone. Canada, Argentina and Egypt have joined the WTO complaint, and nine other countries have registered their support. Some of these countries, probably not coincidentally, are keen to negotiate bilateral trade agreements with the United States.

The timing of the complaint is still curious. There are signs that Europe is at last shifting. New rules on how to label and trace GM products are making their way through the European Parliament. Once they are in force, European officials claim, the moratorium will be lifted. The Americans, having heard such promises before, are sceptical. But the WTO case may make the politics of lifting the ban harder.

More surprising still, the Americans have launched their complaint only a month before big decisions are due on the reform of the EU's common agricultural Policy (CAP). The European Commission is pushing for far-reaching changes, including a separation of the financial support farmers receive from the amount they produce. This is essential to Europe's ability to liberalise its farm trade, which in turn is a prerequisite for keeping the Doha round of trade talks alive. Yet reform is being fiercely resisted by some EU countries, notably France, a staunch opponent of GM food. Infuriating the French over GM food will hardly help CAP reform. Given America's oft-proclaimed commitment to the Doha round, what has prompted it to launch its complaint now?

Domestic political pressure, for one thing. Farm-belt politicians have been shouting that the administration must take the EU to task. For some in the administration, a post-Iraq desire to annoy the French may also play a role. On top of this, there may be a desire to hit back at Europe's behaviour in other trade disputes. Last week, the Europeans upped the ante in a row over America's foreign-sales corporation tax, in which the WTO has already ruled in Europe's favour. The EU announced a list of products on which it might slap tariffs if the Americans do not fix their WTO-illegal practices. The Europeans set a deadline of January 1st 2004, by when they want America's tax code to be put right.

The Americans may also be gambling that the complaint will strengthen their hand in the Doha talks. According to Gary Hufbauer, of the Institute for International Economics, a Washington think-tank, the

Bush administration may be keen to get a WTO ruling in its favour on GM food, so that the issue can be taken into the Doha negotiations. Against that, there is a more alarming possibility: that America has given up hope of CAP reform this year, and hence (at least for now) of any progress in the Doha round. Had the Americans thought there was a serious chance of meaningful farm reform in Europe, thinks Mr Hufbauer, they would have delayed their GM complaint.

The risks stretch further than the Doha round. The GM case threatens to overload the WTO's legal framework. Although the Americans are convinced that they have a clear-cut case, European officials are adamant that the EU has acted within the rules. Independent experts say that the case could go either way. The WTO's rules are too woolly and subject to competing interpretations to deal with scientifically complicated and politically explosive issues. Even if America wins, the EU might ignore the ruling if ordinary Europeans maintain their rejection of GM food. If America loses, domestic opponents of the country's WTO membership may gain in strength. The WTO's credibility, and its rules-based system, would lose either way. That, more than anything else, is why America's decision to launch the case is a high-stakes gamble.

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Hedge funds

An invitation from the SEC

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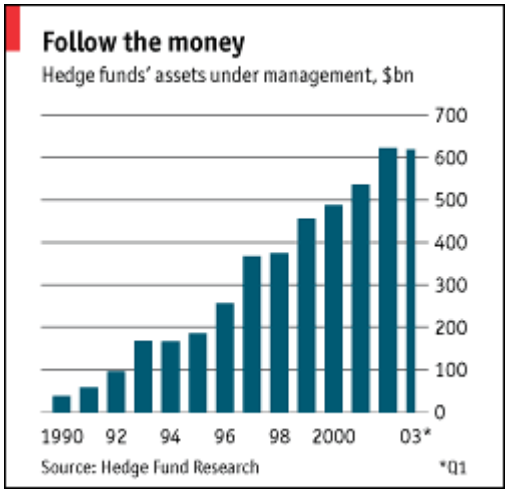
Will America's regulator tighten the rules for hedge funds?

Get article background



NOT since the near-collapse of Long-Term Capital Management in 1998 has America's Securities and Exchange Commission (SEC) taken such a keen interest in hedge funds. The financial regulator began examining these largely unregulated investment pools a year ago, when Harvey Pitt was its chairman. When William Donaldson succeeded Mr Pitt at the beginning of this year, he promised to take a "long, hard look" at hedge funds. On May 14th-15th, the SEC held talks in Washington with fund managers, lawyers and others—without, it said, "preconceived notions"—to explore whether and how to regulate hedge funds.

Hedge-fund managers believe that the SEC—in particular Paul Roye, head of its investment-management division—dislikes their industry. They believe the regulator has already made up its mind to tighten the rules. "These hearings are just window-dressing," says Joe Nesler of Gardner, Carton & Douglas, a law firm in Chicago, who advises hedge funds.

Why have hedge funds caught the SEC's attention? One reason is the industry's growth: the sum under management has ballooned from about $50 billion in 1990 to $600 billion today. Then there are high-profile scandals. Last year the SEC brought 12 cases of fraud against hedge funds, more than twice as many as in each of the previous four years. Third, hedge-fund managers are increasingly selling their wares in a broader market, through funds of funds and other new retail products, rather than sticking to their traditional clientele of rich individuals. The SEC is worried that middle-market investors may not realise what they are buying.

At present, only "accredited investors" who have more than $1m to play with, or an annual income of at least $200,000, and "qualified purchasers" (individuals with at least $5m in liquid assets) may invest directly in hedge funds. These thresholds, originally set in the Investment Advisors Act (IAA) of 1940, have not been updated for years. The SEC is concerned that some investors who qualify for hedge-fund investment today do not understand the risks involved. "They will probably bump up the accredited-investor standard," says Mr Nesler.

Hedge-fund managers are also exempt from the IAA requirement to register as investment advisers with the SEC. Registration means, among other things, regular audits. Jedd Wider of Orrick, Harrington & Sutcliffe, a law firm in New York, thinks that this rule is likely to be amended and that registration with the SEC will become mandatory. Arthur Levitt, a former chairman of the SEC, called for mandatory registration in a speech on May 7th.

Although the hedge-fund industry would find these changes irksome, it is raising few objections. Fund managers' real worry is that they will have to be more transparent about their trading activities. In particular, short-sellers, who try to make money by selling shares they do not own in the hope of buying them back at a lower price, do not want to reveal their positions. They argue that investors who want detailed information about what is being done with their money already have the option of investing in hedge funds that are willing to lay open their portfolios.

Mr Donaldson looks unlikely to go too far on transparency. He said last month that investors should have

the right to invest in riskier vehicles if they wished and the government should not stop them. If the SEC were to demand that hedge funds reveal all of their trading activities, it would reduce them to glorified mutual funds, duller and much less risky. Although the SEC may have little sympathy for hedge funds, neutering them does not seem to be Mr Donaldson's plan.

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Insurance

New lease on life

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The secondary market in life-insurance policies is good for consumers

AFTER savings accounts and government bonds, life insurance may be the most respectable of investments. It was not always so. Until the British parliament passed the Gambling Act in 1774, which banned policyholders from insuring the lives of people with whom they had no documented connection, many life policies were straight bets on whether somebody—a member of the royal family, say—would live or die.

Now, in a faint echo of those times, a secondary market in life-insurance policies is growing rapidly in the United States. Firms buy policies, mainly from older people, at discounts to their face value. They pay all subsequent premiums and collect the proceeds on the death of the insured or the maturity of the policy. Such “life-settlement” firms bought $2 billion-worth of policies (by face value) last year, ten times as much as they acquired in 1998. The industry's potential—Americans aged over 65 have life cover worth perhaps $500 billion—has attracted such investors as General Re, a subsidiary of Warren Buffett's Berkshire Hathaway.

Hitherto, elderly Americans with policies they do not need or cannot afford to keep up have had little option but to let the policies lapse or sell them back to their insurers. Plenty seem glad to have an alternative buyer. No wonder, when on average they can get three times as much from life-settlement firms as they can from their original insurers.

However, the life-settlement business still has to overcome several obstacles. One problem is that its reputation is tainted by association with the viatical industry, which bought the life-insurance policies of the terminally ill, usually with AIDS, and in which fraud was common.

In addition, some life insurers see the life-settlement business as a direct threat. Should the secondary market expand, the proportion of policies that lapse—and on which insurers pay no claims—would drop. Insurers would then have to pay more out. Their profits would fall and premiums would probably rise. So a handful of life-insurance firms are trying to hamper the life-settlement firms' growth by prohibiting their insurance agents from discussing them with clients and by making policies non-transferable.

The legality of such moves is not clear. It is not certain, says Rick Cortese of National Regulatory Services, a consulting firm, that insurance agents have a fiduciary duty to their clients, as brokers selling securities do—or, if they have such a duty, whether it obliges them to discuss life settlements. New rules being drafted by state insurance regulators would explicitly allow agents to talk to clients about life settlements, but would not insist on it. On the transferability question, some states permit insurers to write policies that cannot be sold on. Others, such as North Carolina, Florida and Louisiana, do not.

The economic argument, however, is plain. Before the life-settlement industry grew, life-insurance companies were the sole buyers of unwanted policies. Now consumers have a choice, and the chance to get more if they cash their policies in. And so what if the life-settlement firms profit from their death? Unlike their 18th-century forebears, the policies' buyers have at least asked permission.

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Seismic stockmarkets

Quaking

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A new aid to investment: the Richter scale

THE only predictable thing about stockmarkets nowadays seems to be their tendency for violent swings. Recent months have seen daily price rises and falls of 1-2%. Such tremors leave journalists reaching for the odd volcanic or earthquake metaphor.

That might be appropriate, says a team of four researchers led by Xavier Gabaix, an economist at the Massachusetts Institute of Technology (MIT). The team has published an article in the May 15th issue of *Nature* which provides evidence that stockmarkets before a crash behave rather like the earth before a big earthquake. Have the anoraks' insights trumped those of their peers in the finance faculty?

At first glance, perhaps. The authors demonstrate a well-known mathematical pattern in stockmarkets called a “power law”. Stockmarkets obey a type of power law when the number of daily price-swings of 1% is, say, eight times the number of days seeing a 2% move, which is in turn eight times the number of 4% days. Power-law patterns are similar to the statistical distributions of seismic activity, which inspires hope of predicting both types of calamity. But these patterns in stockmarkets, say the authors, explain more than just price movements. They also describe two other big factors in markets: trading volume and the size of mutual funds.

Indeed, their key finding is that many market moves, seemingly unrelated to news about profits or the economy, are caused by big mutual funds trading under time pressure. Another lesson is that analysts tend to neglect the possibility of very rare, but very bad, outcomes.

This is not the first time that scientists have trained their prowess on financial markets. A few years ago, chaos theory was set to revolutionise trading. Models of ecosystems developed by biologists have been tried too. Sadly, few attempts have yielded much profit. But the ideas keep coming. Astrophysicists have recently pointed to similarities between solar winds and the Dow Jones Industrial Average. In the 19th century, W.S. Jevons, an English economist, linked sunspots and harvests.

Can the earthquake approach see off another crash? Do not get your hopes up. The authors say a lot of “friction” (taxes or other trading curbs) would be needed to frustrate the market. Market crashes are rooted not in the stars, nor in the earth, but in traders themselves.

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Corporate restructuring

Liar's poker

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Marconi's tortuous workout is not a blueprint for others

THE shares and bonds of a reborn Marconi, a British manufacturer of telecoms equipment, are due to begin trading on May 19th. This marks the end of a messy debt workout that started 18 months ago. It nearly foundered several times on the arrogance, opportunism and brinkmanship of the negotiating parties.

Marconi's case is a good example of the growing complexity of corporate workouts. No longer is it only company executives and their bankers that sit round a table rescheduling loans. Others also have seats, including investors who bought loans and bonds at a discount, and those who have bought credit-default swaps—insurance against a company's going bust.

The old, straightforward clash between a company and its creditors has been replaced by a mish-mash of interests. For example, an investor who bought debt yesterday at 20% of face value might be happy to be repaid tomorrow at 25%, whereas another—an insurance company, say, that paid the full price for the bonds as a long-term investor—might prefer to recover 75% in three years' time. The holder of a credit-default swap might prefer the company to go into bankruptcy. More complicated still, some around the table may be trading in and out of their positions each day, with their motives changing accordingly.

The protagonists in the Marconi case learned about such dynamics the hard way. Marconi's forerunner, GEC, used to enjoy a AAA credit rating, the highest possible. But after the company changed its name and went on an acquisition binge, it fell victim to the bursting of the telecoms bubble. It issued a profit warning in July 2001. By September the price of its shares had fallen by 80% and that of its bonds by 65% (see chart). It had about £4 billion ($6.4 billion) in debt, half in bank loans and half in bonds.

Under a new chief executive, it began to renegotiate its bank loans. Meanwhile, it decided, rather cheekily, to buy some of its bonds back at half price—without consulting the banks. If the banks were cross then, they were furious in March 2002: on the brink of signing a deal, Marconi decided to ditch their plan and try to restructure all its debt, including the bonds. One reason for the banks' rage was the failure of their plan to make their rescheduled loans senior to Marconi's bonds. Because Marconi had been a AAA credit, they had not bothered to put in covenants that would have done this, never imagining a restructuring in which seniority of credit would matter.

Enter, at this point, an “ad hoc” committee of bondholders led by Bingham McCutchen, an American law firm, and Greenhill, an investment bank, both specialists in corporate workouts. The crew included some big American insurers and opportunist funds (also known as vulture funds), such as Appaloosa Partners, Cerberus Partners and Angelo, Gordon. Initially, the banks could hardly bring themselves to talk to these interlopers.

The complexity increased. Bondholders left and rejoined the committee, depending on whether they wanted inside information or the freedom to trade (committee members are often barred from trading when market-sensitive information is disclosed). A few banks did likewise. Those leading the restructuring could only speculate about the motives of some people at the table. There was great uncertainty over whether credit-default swaps had been triggered (in fact, they never were). Some banks seemed keen for Marconi to die, which suggested that they had credit insurance.

Creditors are not obliged to disclose their interests, or changes in them, although INSOL, an international association of insolvency experts, recommends early disclosure of such trading positions “wherever practical” in workouts involving many creditors. Regulators, such as Britain's Financial Services Authority, seem content to let the market set its own disclosure standards. Bankers, on the other hand, suggest that trading restrictions on creditors that have been privy to sensitive information should be tougher in future.

Marconi's liabilities were further complicated by an ill-conceived attempt to hedge its employee share-ownership programme (ESOP). Marconi had bought an equity swap in 2000 to cap the price of its own shares, which it would need to provide to its employees under the ESOP. But the swap had no protection against a fall in the share price (presumably it was unthinkable). That left Marconi with a liability of up to £337m with three banks. It took until March this year to resolve this particular conundrum.

All the while, Marconi managed to honour its obligations to suppliers and other trade creditors, although some payments were stretched. It also had a pile of ready cash, raised by selling off affiliate holdings. So it was not a pushover for its creditors, even though its bond buyback seemed “tantamount to enemy action”, recalls one banker.

On May 19th a new Marconi is expected to issue a billion new shares, new warrants for 50m shares and $1.2 billion of dollar and sterling notes. There is no guarantee that the company will live happily ever after. Meanwhile, workouts are getting no easier. Only this week a Swiss company was taken to the brink of bankruptcy by maverick bank behaviour: credit derivatives were the suspected cause. All this is good for lawyers, good for insolvency experts, and good for vulture funds. And as one participant notes: “Vultures and hyenas do keep the bush clean.”

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Economics focus

Paying for Saddam's sins

May 15th 2003
From The Economist print edition

Should the new Iraq honour the financial obligations of the old regime?

CONTEMPLATING the victorious allies at the Versailles peace conference in 1919, Keynes observed that “reparation was their main excursion into the economic field, and they settled it as a problem of theology, of politics, of electoral chicane, from every point of view except that of the economic future of the states whose destiny they were handling.” He rightly foresaw that this neglect would have disastrous consequences, notably in Germany. As the United Nations Security Council now considers how to rebuild Iraq, is history destined to repeat itself?

The precise text of any resolution on Iraq the UN will pass remained uncertain as *The Economist* went to press. But the draft tabled by America and Britain on May 9th would have pleased Keynes. It does not impose new reparations from Iraq to cover the cost of the recent war. But it does propose a way to manage revenues from the sale of Iraq's oil, which is practically the country's only significant asset. The plan could greatly reduce the pain of the financial burden bequeathed by Saddam Hussein.

By some calculations, the dictator left his country in hock to the tune of $350 billion, a crippling burden given that a “normal” country with the sort of GDP that seems plausible for Iraq in the medium term could probably comfortably service debts of only around $80 billion, according to Edwin Truman of the Institute for International Economics. Of these potential obligations, over $200 billion is war reparations, mostly arising from the invasion of Kuwait in 1990. Under the existing UN oil-for-food programme, some 25% of the revenues from sales of Iraqi oil go to a reparations compensation fund.

Under the proposed UN resolution, this slice of revenues would fall to 5%. Clearly, the dollar amount this represents will depend on the amount of revenue. Although Iraqi oil production seems unlikely to recover quickly, in the medium term revenues should be far higher than under the oil-for-food programme. But, although a 5% share of revenues is not full forgiveness of war reparations, it ought not to be unmanageable so long as the rest of Iraq's debt burden is reduced and it can borrow fresh capital from abroad.

Here, a second part of the draft resolution tabled by America and Britain is intriguing. All revenues from sales of Iraqi oil, according to the proposal, “shall be immune from judicial, administrative, arbitration or any other proceedings” relating to claims “of whatever kind and whenever accrued” against Iraq or its agents. According to Patrick Bolton, an economist at Princeton, laying legal claim to Iraqi oil revenues had seemed the likeliest way for creditors to get some money back. At the very least, this wording would give Iraq a strong hand in any formal Paris and London Club debt renegotiations. It might even allow it to repudiate its old debt and still raise fresh capital, says Mr Bolton.

Some American officials have made no secret of their preference for Iraq's debts to be written off, to let its new regime start life with a clean slate. Critics of this idea make two main points: that to pursue it would be bad politics; and that it would be bad for the international debt market and Iraq's place in it.

The political risks are obvious. Iraq owes America little money. Its two biggest creditors by far are France and Russia, countries which opposed the war against Saddam and can veto any UN resolution. It would come as no surprise were they to veto immunity for oil revenues, or require it to be temporary.

The case for debt forgiveness has been well-rehearsed in recent years, not least in the debate over the HIPC plans for relieving the debts of the poorest countries. Strikingly, two of the main arguments against forgiveness hardly apply to Iraq. There is no obvious “moral hazard”: forgiveness would not reward any bad behaviour of a new Iraqi government, nor—given the unique circumstances—would it generate

expectations that similar generosity would be forthcoming in future. Likewise, because a new government would be clearly unconnected to the Saddam regime, refusing to repay all its debts might not hinder the government from borrowing fresh capital—though it is certainly plausible that creditors might look more kindly on Iraq, and thus charge it a lower rate of interest, if it continued to pay existing creditors something, after a formal rescheduling, as evidence of its good intentions over new borrowing.

Owed by the odious

Some economists, such as Michael Kremer of Harvard University, argue that, after a change of regime, a country's new government should have no legal obligation to service the “odious debt” of an illegitimate predecessor, an idea dating back to the Spanish-American war of 1898. In theory, establishing the right of a country to write off odious debt would have potentially huge benefits, not least by discouraging banks from lending to nasty governments that might one day be overthrown. Indeed, says Mr Kremer, setting out precise rules for what counts as an “odious regime”, and thereby making it harder for such regimes to borrow, may be a better form of economic sanction than the traditional approach of obstructing trade. Restrictions on trade hurt ordinary people, whereas making it harder to borrow hurts the baddies in charge more directly.

If applying the odious-debt doctrine to future debt can make good sense, applying it retrospectively to debt already incurred, as in Iraq, is less straightforward. As Harold James, another Princeton economist, has argued, this could destabilise the global credit markets by making creditors fearful that other countries might one day describe their debt as odious. It is not hard to imagine circumstances in which, say, a newly democratic China might try to shed the external debt—$170 billion at the end of 2001—of the “odious” undemocratic regime it replaced. He has a point: although, given the needs of Iraq, Keynes might well have dismissed it as unhelpful theology.

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Miniature fuel cells

Batteries not included?

May 15th 2003 | NEW ORLEANS
From The Economist print edition

Will tiny versions of the fuel cells now being developed for cars soon power laptop computers too?

Get article background

AS VIDEO telephony, broadband internet links and other high-powered features are added to laptop computers, personal digital assistants (PDAs) and mobile phones over the next few years, the energy demands of these devices will soar. The Samsung Advanced Institute of Technology, the research arm of the *chaebol* of that name, estimates that such upgraded portable devices will require power sources with at least 500 watt-hours per kilogram of energy stored in them. Lithium-ion batteries, today's best, can manage half that, but even the most optimistic estimates suggest that only a 30% improvement could be squeezed out of such batteries.

But there may be an alternative. Miniature fuel cells, which generate electricity by reacting hydrogen with oxygen, can do much better than batteries—at least in a laboratory. The question is whether they can ever do so in the real world. This was the subject of a conference organised last week in New Orleans by the Knowledge Foundation.

It's not a gas

The key to making fuel cells small is to replace the hydrogen—or, rather, to deliver it in a non-gaseous form, since it is hardly practical to fit portable electronic devices with pressurised cylinders. In the long run, there may be ways round this, for instance by absorbing the gas in metal hydrides or carbon nanotubes. But in the short term the solution seems to be to deliver the hydrogen as part of a hydrogen-rich compound, such as methanol. This is a liquid, which means it is easy to handle. Sachets of methanol fuel, purchased at newspaper kiosks, rather like refills for cigarette lighters, could be inserted with little fuss into electronic devices.

There are two ways to get the hydrogen out of methanol in a way that a fuel cell can use. One, being pursued by several companies, notably Motorola, is called reformation. This attempts to replicate in miniature the complicated networks of piping, heaters, vaporisers, heat exchangers and insulation that the petrochemical industry uses to extract hydrogen in bulk from methane, a chemical one oxygen atom

different from methanol. That is hard—doubly so, since reformation works best at 200°C.

There are some variations on the theme, but most of those building miniature methanol reformers use an approach not much different from the one used to make circuit boards for computers. They laser-drill holes into tiny ceramic wafers to guide the flow of fluids. Then they stack these one on top of another, like layers of a sandwich, sinter them together at a temperature of 800°C, and laminate them. Presto, a mini-chemical plant.

The alternative to reformation is to feed the methanol directly into the cell, and rely on a catalyst to break it up at the electrodes, where the hydrogen is separated into its constituent electrons (which form the current that the cell produces) and protons. The trouble with this approach is that pure methanol tends to get everywhere, and thus wrecks the cell. Diluting it with water reduces this problem, but also reduces the power output.

At least one firm, however, thinks it can get round this. MTI MicroFuel Cells, based in Albany, New York, boasts some top researchers poached from the Los Alamos National Laboratory in New Mexico. One of them, Shimson Gottesfeld, told the conference that the firm has developed a cell that can use undiluted methanol. This, he claims, allows it to achieve more than three times the energy density of lithium-ion batteries.

Dr Gottesfeld was reluctant to go into details. But the secret seems to lie in some clever internal geometry, which eliminates the need for pumps. That, in turn, reduces the tendency for methanol to go where it is not wanted. However the trick is performed, though, MTI has working prototypes. It also has a contract. Its cells are due to go to market next year as part of a hybrid power-pack (that is, one which also involves batteries) being built by a large equipment firm called Intermec for use in handheld computers.

Better ways of handling methanol are not the only possibility, though. Another is to find further alternatives to elemental hydrogen. That is the route chosen by Medis Technologies, an Israeli-American firm. Its fuel is a mixture of glycerol and sodium borohydride. These react in the presence of a platinum and cobalt catalyst, generating protons and electrons in the same way as methanol—or, indeed, pure hydrogen.

Although many at the conference were sceptical, suggesting for example that the Medis cell works only when it is standing up, the firm remains bullish. Gennadi Finkelshtain, Medis's principal scientist, acknowledges his device's sensitivity to its orientation, but insists that he has a solution in the works. The fact that he has persuaded General Dynamics, a big defence contractor, to form a partnership with him to supply the American armed forces with the new device suggests that the problems cannot be too great. Medis showed off a prototype recharger for a “ruggedised” military PDA that it says it will start manufacturing next year.

None of this adds up to a revolution in portable power, of course, but it is a tantalising start. As so often with new technologies, military applications are important drivers. The American army is keen to have more energetic and longer-lived power sources for such things as climate-controlled bodysuits, advanced mobile-communications equipment and more sophisticated sensors. But consumers will soon be able to purchase lightweight fuel cells, too. Even though they are unlikely ever to be compact enough for use in mobile phones, they could act as portable chargers for such phones. And in devices that are only a bit larger, they could, indeed, end up replacing batteries.

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More about fuel cells

Iceland powers up

May 15th 2003 | REYKJAVIK
From The Economist print edition

You can now buy hydrogen from a garage in Iceland

Get article background

LIKE a kettle near boiling point, the countryside outside Iceland's capital is perforated with vents and geysers letting off steam from the volcanic cauldron simmering just below the island's surface. This steam, together with hydroelectricity, provides 72% of Iceland's energy. But that is only the start. In a bid to become the world's first “hydrogen economy”, the government hopes to raise the figure to 100%.

This explains the excitement felt when a new pump was added recently to a service station just outside Reykjavik. Instead of petrol or diesel, it pumps hydrogen. Although this is not the world's first hydrogen filling-station, it is the first to be open to the general public. It is designed for vehicles that are powered by fuel cells, which react hydrogen with oxygen from the atmosphere to produce electricity. The other first is that the hydrogen itself is produced by the electrolysis of water—the electricity in question coming from all that environmentally friendly energy.

The only fly in the ointment is that there are, for the moment, no customers. But that will change when the country's bus fleet starts to convert to fuel-cell-powered vehicles in a few months' time. Eventually, the government hopes that private drivers will follow suit. In retrospect, Leif Eriksson, the Viking explorer who sailed from Iceland and discovered Greenland, got the names backwards. It is Iceland which is bidding to become the world's greenest country.

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HIV-2

The other AIDS epidemic

May 15th 2003
From The Economist print edition

Twenty years after the first AIDS virus was identified, news about a second

“A RETROVIRUS belonging to the family of recently discovered human T-cell leukaemia viruses (HTLV), but clearly distinct from each previous isolate, has been isolated from a Caucasian patient with signs and symptoms that often precede the acquired immune deficiency syndrome (AIDS).”

With these words, in a paper published 20 years ago this week in *Science*, Luc Montagnier of the Pasteur Institute in Paris announced that he had isolated the virus that causes AIDS. He called it LAV (lymphadenopathy-associated virus). Now, after a priority dispute with Robert Gallo, an American researcher who claimed to have discovered it independently, and who called it HTLV-3, it has become more familiar under its compromise moniker, the human immunodeficiency virus, HIV.

In the decades since Dr Montagnier's paper, HIV has run riot. The latest report on the epidemic, issued on May 13th by the Global HIV Prevention Working Group, a committee of the great and good, reiterated how bad things are. If nothing changes, the world faces 45m new infections between now and 2010. And what needs to change, naturally, is that more money must be spent on prevention. The group thinks that tripling global spending to $5.7 billion by 2005 would be enough to do the job.

That would certainly be wise. But in all the brouhaha, it is easy to forget that the full name of the virus is HIV-1. For in 1986 a second AIDS-causing agent, now known as HIV-2, was isolated by Dr Montagnier's laboratory. And an important aspect of this virus's spread has just been elucidated in a paper in the *Proceedings of the National Academy of Sciences*.

HIV-2 has not rampaged to the same extent as HIV-1. It is more or less confined to West Africa, and it is believed to infect “only” about 1m people (HIV-1 infects more than 40m). Unlike HIV-1, which seems to be a chimpanzee virus that leapt the species barrier to infect people, HIV-2 came from a monkey called the sooty mangabey. When that happened, and exactly how the virus subsequently got its grip, have remained unclear. Until, that is, Anne-Mieke Vandamme, of the University of Leuven, Belgium, and her colleagues, examined the virus's genetic material. Now, they think they know.

HIV-2 seems to have leapt the species barrier twice, once in 1940, and again in 1945. These dates, though hedged within generous margins of error, can be estimated by looking at infected tissue samples taken at various times since, seeing how the virus's genetic sequence has changed over the years, and extrapolating backwards.

This explains a paradox about HIV-2's origin and spread. The evidence on the ground suggests that it started in Guinea-Bissau, in the 1960s, when that country was a Portuguese colony. But sooty mangabeys were extinct in the area by then. In the 1940s, though, they still thrived.

What seems to have happened, according to the genetic sequences, is that the virus was rare until the 1960s, and then started to spread rapidly. Its spread coincided with Guinea-Bissau's war of independence from Portugal, which began in 1963 and went on until 1974. War, with its attendant movement of armies of sexually active young men, provides an ideal climate for the spread of a virus such as HIV-2. Before the war started, it was confined to the colony. Afterwards, it spread not only around Guinea-Bissau, but to many of the country's neighbours as well. When sorrows come, they come not as single spies, but in battalions.

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Overfishing

Ocean's eleventh hour?

May 15th 2003
From The Economist print edition

Fish stocks are dropping rapidly. Predators are falling fastest

Get article background

WHEN prehistoric man arrived in new parts of the world, something strange happened to the large animals. Mammoths, mastodons, massive ground sloths, woolly rhinoceros, cave bears and large flightless birds suddenly became extinct. Smaller species survived. The large, slow-growing animals were easy game, and were quickly hunted to extinction. Now something similar could be happening in the oceans.

That the seas are being overfished has been known for years. What Ransom Myers and Boris Worm of Dalhousie University in Halifax, Nova Scotia, have shown is just how fast things are changing. They have looked at half a century of data from fisheries around the world. Their methods do not attempt to estimate the actual biomass (the amount of living biological matter) of fish species in particular parts of the ocean, but rather changes in that biomass over time. According to their paper in the latest issue of *Nature*, the biomass of large predators (generally the most valuable species) in a new fishery is reduced on average by 80% within 15 years of the start of exploitation. In some long-fished areas, it has halved again since then.

The researchers' data came from two sources. Those for fisheries on the continental shelves were derived from standardised research surveys of large bottom-dwelling fish such as cod, flatfish, skates and rays. Those for fish in the open ocean, such as tuna, billfish and swordfish, were estimated from figures collected by Japan's longline fishing fleet (composed of vessels that trail fishing lines with baited hooks at intervals along their lengths). In this case, changes in biomass were estimated by comparing the number of fish caught for every 100 hooks now and in the past.

Dr Worm acknowledges that the figures are “only a first order approximation” but says that if anything they are conservative. One reason for this is that fishing technology has improved, so the comparison is not genuinely like-for-like. Today's vessels can find their prey using satellites and sonar, which were not available 50 years ago. That means a higher proportion of what is in the sea is being caught, so the real difference between present and past is likely to be worse than the one recorded by changes in catch sizes. In the early days, too, longlines would have been more saturated with fish. Some individuals would therefore not have been caught, since no baited hooks would have been available to trap them, leading to an underestimate of fish stocks in the past. Furthermore, in the early days of longline fishing, a lot of fish were lost to sharks after they had been hooked. That is no longer a problem, because there are fewer sharks around now.

This sort of result does not, of course, convince everyone. The Inter-American Tropical Tuna Commission, an inter-governmental body that manages tuna fisheries in the eastern Pacific, has a different view of the status of tuna stocks. Robin Allen, its director, says longlines only catch older tuna, and the data the authors are using therefore comprise only part of the actual stock. Other studies are necessary, he says, to work out the relationship between reductions in catch rates and actual removals from stock.

Dr Myers and Dr Worm, however, stand by their conclusions. They argue that their work gives a correct baseline, which future management efforts must take into account. They believe the data support an idea current among marine biologists, that of the “shifting baseline”. The notion is that people have failed to detect the massive changes which have happened in the ocean because they have been looking back only a relatively short time into the past. As Jeremy Jackson of the Scripps Institution of Oceanography, in La Jolla, California, puts it: “We had oceans full of heroic fish. Hemingway's ‘Old Man and the Sea' was for real.” That matters because theory suggests that the maximum sustainable yield that can be cropped

from a fishery comes when the biomass of a target species is about 50% of its original levels. Most fisheries are well below that, which is a bad way to do business.

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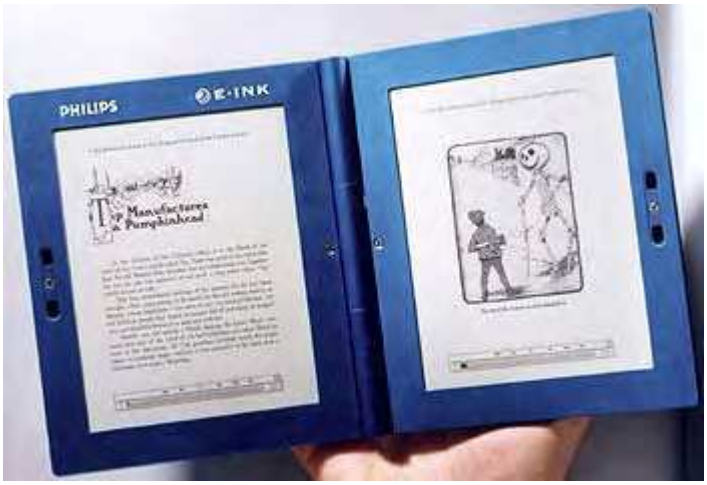
Electronic displays

May 15th 2003
From The Economist print edition



A new type of electronic display will be demonstrated by E Ink Corporation, based in Cambridge, Massachusetts, and the Dutch multinational Philips at a meeting next week in Baltimore. The prototype has a resolution of 160 pixels per inch, paper-like readability and low power consumption, though it cannot handle moving pictures yet. Both companies say they are on target to commercialise this kind of display by 2004. Black and white pixels, the individual elements of the picture, are produced by electronics that move electrically charged white chips to either the front or the rear of capsules of black ink that cover the surface of the display. E Ink hopes that this is a step on the road to flexible electronic paper. Earlier this month, the firm published a paper showing how such a flexible display might be built.

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The Supreme Court

First among equals

May 15th 2003
From The Economist print edition

AP

Just how do the justices wield influence on the Supreme Court? Two new books come to a surprising conclusion

Get article background

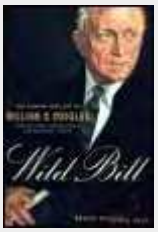
THE nine justices of America's Supreme Court like to present a unified image of rectitude, prudence and wisdom. But such powerful positions have invariably attracted a wide variety of people, from the rabidly ambitious to the fervently public-spirited. And among this motley group, it is difficult to imagine a starker contrast than that between William O. Douglas and Sandra Day O'Connor.

Douglas was a restless and unpredictable maverick, as Bruce Murphy's excellent new biography makes clear. Desperate to succeed as a lawyer and politician in Franklin Roosevelt's New Deal Washington, Douglas was also something of a fantasist. His inveterate womanising and heavy drinking were known about, but it took Mr Murphy to discover just how much of his swashbuckling personal history—including service in the first world war and triumph over polio—was pure invention.

Appointed to the court in 1939 at only 40, Douglas was nevertheless bitterly disappointed not to win a Democratic nomination for president or vice-president. He consoled himself on the court by becoming its most left-wing and outspoken member, even on the liberal Warren court of the 1950s and 1960s. By the time he retired in 1975, Douglas had become a hero to many environmentalists and civil libertarians, the very model of what a visionary on the bench could achieve by means of a potent intellect and eloquent pen.

As the first woman ever to sit on the Supreme Court, Ms O'Connor has an even greater claim than Douglas to being a legal pioneer, but she is rarely trumpeted as anyone's heroine. A legislator and judge in Arizona, she was, even by her own account, surprised to be plucked from relative obscurity by President Ronald

Wild Bill: The Legend and Life of William O. Douglas
By Bruce Allen Murphy

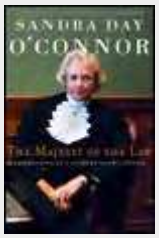


Random House; 736 pages; $35

Buy it at
Amazon.com
Amazon.co.uk

The Majesty of the Law: Reflections of a Supreme Court Justice
By Sandra Day O'Connor

Reagan in 1981 to sit on the Supreme Court. Her new book, given the constraints of discretion imposed on any sitting justice, is remarkably good—a clear-eyed, well-written civics lesson aimed at general readers. She has managed to knit together personal reminiscences, brief historical essays and some useful suggestions for potential reforms into a stimulating and thoughtful description of how America's court system actually operates.



Random House; 352 pages; $25.95

Buy it at
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And yet the book will do little to reverse her reputation among many legal observers as an earnest but plodding mediocrity, the very opposite of the flamboyant Douglas. To her critics, Ms O'Connor is muddled, a judge who lacks not only a colourful pen but also a clear set of standards by which to be guided. Too often she cannot make up her mind, they say, and when she does she frequently seems to contradict her own earlier opinions.

But history is likely to reverse these conventional views, and these two books make clear why. By Mr Murphy's well-documented account, Douglas was not only quick-witted, but impatient, abrasive and bored with the whole process of judging. His vote on the Warren court was often a foregone conclusion, so he exercised little influence over his brother judges, and his best-known written opinions and dissents were often, behind a few glittering phrases, dashed off and slipshod in their reasoning. They have also exercised little influence over the justices that have come after him.

Ms O'Connor, by contrast, takes the task of judging extremely seriously, and more importantly, she sees it not as a chance to impose her own policy choices on the nation, but as a careful balancing of conflicting claims and rights, a weighing of arguments in particular cases. She is also acutely aware of the Supreme Court's place in America's overall political system, and of its need, if it is to be effective, to tread carefully. In her dislike for absolutes, she is more in tune with the spirit of American democracy and jurisprudence than a brilliant polemicist like Douglas.

In the longer term, Ms O'Connor's tenure on the court is likely to be seen, for good or ill, as more influential than that of any of the other justices with whom she has served, primarily because she has most often been, on a divided court, the swing vote. She is a natural conservative, and has often voted with the conservative majority in controversial 5-4 divisions. But she is persuadable, and the two sides in closely fought cases have had to aim their arguments at her. Even when she has sided with the conservatives, she has often narrowed and restrained their rulings.

Speculation is rife about a retirement from the court this year, which would give President Bush a chance to tilt the balance further in a conservative direction. If William Rehnquist, the chief justice, retires, Mr Bush will not get that opportunity, because Mr Rehnquist's vote is already firmly in the conservative camp. If Ms O'Connor retires, Mr Bush could dramatically change the equilibrium of the court with a single appointment.

Is Ms O'Connor, at the age of 73 and after 21 demanding years on the court, ready to go? Her new book contains an intriguing clue. On the book's second page she describes the relationship between a justice and the court as a “marriage” which “barring impeachment, lasts until death does them part”. It sounds as though the swing vote is staying put.

Wild Bill: The Legend and Life of William O. Douglas.
By Bruce Allen Murphy.
Random House; 736 pages; $35

The Majesty of the Law: Reflections of a Supreme Court Justice.
Sandra Day O'Connor.
Random House; 352 pages; $25.95

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The bushmeat trade

Killing off the ark

May 15th 2003
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IF EATING people is wrong, then what about apes? They are, after all, man's closest siblings in the wild, and they share as much as 99% of the human genetic code. Such considerations have been insufficient to stop the trade in bushmeat from becoming a huge commercial enterprise in western and central Africa, where ourclosest living relatives—the last gorillas, chimpanzees and bonobos—are rapidly being gobbled up.

The forest people of middle Africa have always lived off game meat. But only in recent years, with the arrival of significant quantities of automatic weapons and the opening up of hitherto inaccessible forests by European and Asian companies, has the African bushmeat trade become unsustainable. At its root is a growing hunger not so much for meat but for timber. The logging companies, often working on projects that are financed for the most laudable of reasons by the European Union and the World Bank, build forest roads and send in their trucks. The hunters follow easily, with the result that meat is coming out as never before.

Reaching any sensible conclusion on the numbers of animals being killed is not easy. The anecdotal evidence, however, is there for all to see: even tiny village markets in central Africa often sell smoked ape meat, particularly in Congo and the former Zaire, now the Democratic Republic of Congo, where it is regarded as a delicacy.

Dale Peterson, the author of this disturbing exposé, is a veteran writer on primates. Karl Ammann's stark photographs of severed gorilla heads and orphaned infant apes, taken over the past few years, are a terrible indictment of what he calls “feel-good conservation” and its failure to curb the trade and stop the collapse of the world primate population. The slaughter of apes for food is a personal nightmare for both men. The killing of a chimpanzee—a species that can make tools and is capable of laughter—is, they insist, an act of murder. And yet the western media have largely ignored the issue. “This book touches subjects that people may prefer not to talk or think or read about...It's about hard choices and serious ethical and cultural conflicts.”

Apes are not the only species in Africa to be threatened with extinction by an upsurge in the demand for meat. Most of Africa's wildlife trade is legal but a significant part is not, and keeping tabs on this is becoming ever more of a challenge. The United Nation's Convention on International Trade in Endangered Species—CITES—is the regulatory body in charge. While most people would agree that conservation is impossible without regulation, “The Trade in Wildlife” argues that CITES is having little success in stopping certain species from becoming extinct. Moreover, animal conservationists disagree about what needs to be done. This book, with its critical assessment of the wildlife trade, comes not a moment too soon and carries an important message. In the end, regulations will work only when they are accepted by those most affected by them—the people who deem primates to be more valuable as dead meat than live animals.

Eating Apes
By Dale Peterson

University of California Press; 333 pages; $24.95 and £17.95

Buy it at
Amazon.com
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The Trade in Wildlife: Regulation for Conservation
Edited by Sara Oldfield

Earthscan; 232 pages; $29.95 and £17.95

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About sponsorship

Ethical living

Good of the people

May 15th 2003
From The Economist print edition

A PAIR of quotations from Junichiro Tanizaki, a Japanese writer, on the loveliness of laquerware almost leads one to expect a book on the contemplation of beauty. Although more is promised on aesthetics, it never appears. A.C. Grayling, an academic philosopher, has a fiercer subject in view: he wants to track men's arguments about the nature and source of morality by expounding the evils of religion and lauding the progress of science.

What is Good? The Search for the Best Way to Live
By A.C. Grayling

Weidenfeld & Nicolson; 241 pages; £18.99

Buy it at
Amazon.co.uk

Religion, of course, deserves all it gets from him as a means of oppression and a cause of war. Darkness descends for Mr Grayling, as for most modern philosophers, around the 5th century, lifting only with the Enlightenment. Even after this, the struggle against recidivism, superstition and fundamentalism can never be relaxed for a moment. Mr Grayling emphasises that morality enforced by belief in a supernatural policeman is no morality at all; it is the result not of choice or altruism, but of fear. Once religion loses its claim to be a guarantor of public morality, there is, as he says, no argument for an established church in any intelligent democracy.

The ideal morality, as this book describes it, is perfect autonomy of the individual, governed by reason and constrained only by natural altruism and social norms. It is hard to disagree, though the philosophical road to this ideal has been a bumpy one; in ancient Greece alone, thinkers could choose between Aristotle's appeal to rationality, Diogenes's impulse to live by animal instinct and Epicurus's ideal of civilised conversation with friends. In the 18th century, David Hume's theory that morality sprang from feelings was balanced by Immanuel Kant's notion that an inner sense of duty produced it. Modern times are no clearer: Mr Grayling's 20th-century section consists entirely of Freud, with all his faults.

The book's greatest limitation, though, is its failure to grapple intelligently with the issue of transcendence. This is not at all the same as religion, though here tarred with the same brush. Mr Grayling admits—he has to—that some of the greatest and freest thinkers, among them Plato, Kant and Voltaire, lived comfortably with the notion of a deity; he quotes J.S. Mill admitting that the poetry of Wordsworth, which glows with transcendence, had taught him “the perennial source of happiness”. The divide between this utterly unoppressive principle and the Judeo-Christian God-as-commander is wide indeed, yet hardly as daunting as presented here. By disdaining to understand the real effect of either idea on human minds, Mr Grayling distorts and impoverishes what could have been a powerful argument in favour of moral freedom.

What is Good? The Search for the Best Way to Live.
By A.C. Grayling.
Weidenfeld & Nicolson; 241 pages; £18.99

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About sponsorship

Asia's criminal underworld

Love, money and revenge

May 15th 2003
From The Economist print edition

TRIADS, tongs, yakuza, pirates and opium lords, to say nothing of the emergent Russian *mafiya*—the world of Asian crime seems incorrigibly glamorous, except, of course, to those who find themselves on the wrong side of these secret societies. Bertil Lintner, a reporter at the *Far Eastern Economic Review*, has put together a useful guide that looks beneath the surface of these criminal groups, tracing their history back to the 19th century and speculating on their prospects for the future.

Full of anecdote—from drunken Chinese pirates singing Ricky Martin songs as they are led away to be executed to tips on how best to launder money in Vanuatu—the book also highlights some important themes. One of these is the extent to which criminal societies enjoy close links to law-enforcement agencies, one example being the attitude of the Beijing government towards the triad societies of Hong Kong at the time of the colony's reversion to Chinese rule in 1997.

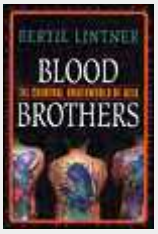
Far from being an evil to be stamped on, Mr Lintner explains, the triads were regarded as patriotic organisations to be treated with respect. Perhaps one should not be surprised: both the Chinese Communist Party and its antithesis, the Kuomintang, had intimate links with the gangs that in effect ruled Shanghai during the first half of the last century, as Mr Lintner also chronicles. An interesting accessory to this history is a list of the 36 oaths of the triads, which threaten death by “five thunderbolts” or by a “myriad of swords” for those who break them.

The other thread running through the book is the degree to which crime in East Asia is now an international phenomenon. The Chinese diaspora is one obvious factor at work here, but it is not the only one. Sydney, for instance, is plagued by a particularly vicious Vietnamese gang called the 5T, named for the Vietnamese words for love, money, prison, crime and revenge.

For more detail on Japan's criminal underworld, one may consult David Kaplan's latest version of his 1986 classic, “Yakuza”. For five years after it was first published, the book was not available in Japan. Mr Kaplan was turned down by 18 publishers before a small house agreed to bring out a Japanese-language edition. Many bookshops are still wary of stocking it. The sinister and bizarre yakuza, with their full-body tattoos and missing fingers, inspire genuine fear in ordinary Japanese. Yet at the same time, they occupy an almost respectable position in society. Every year, Japan's national policy agency publishes figures listing the precise number of yakuza gangs and gangsters.

As Mr Kaplan reports, it is only in the last few years that the Japanese government has started to get tough with the yakuza. In 1999 it began allowing the use of electronic eavesdropping to combat organised crime. But the yakuza were ready. For the past two decades, they have been diversifying abroad, into the sex industry, drugs and the trafficking of women. As the climate has worsened in Japan, they have simply moved more of their business offshore: first, following the sex-tourists, to the Philippines and the rest of South-East Asia, and more recently to Latin America and even Europe. They have also moved into legitimate businesses. One of the largest investors in Japan Airlines is a branch of the Yamaguchi-gumi, the most infamous of the yakuza gangs.

Blood Brothers: The Criminal Underworld of Asia
By Bertil Lintner



Palgrave Macmillan; 480 pages; $29.95

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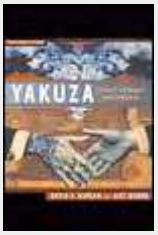
Yakuza: Japan's Criminal Underworld
By David E. Kaplan and Alec Dubro



University of California Press; 423 pages; $60 (hardback) and $19.95 (paperback).
Robert Hale; £25

Buy it at
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Blood Brothers: The Criminal Underworld of Asia.
By Bertil Lintner.
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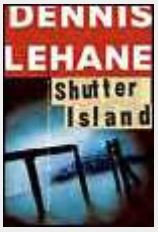
New fiction

Dark and stormy nights

May 15th 2003
From The Economist print edition

AFTER a string of commercially and critically successful thrillers, Dennis Lehane hit the big time in 2001 with “Mystic River”, which quickly became a bestseller and has just been made into a film by Clint Eastwood. The movie rights to his latest book, “Shutter Island”, have already been snapped up by Wolfgang Petersen, who directed “Das Boot” and “The Perfect Storm”.

Shutter Island
By Dennis Lehane



William Morrow; 336 pages; $25.95.
Bantam Press; £10

Buy it at
Amazon.com
Amazon.co.uk

Certainly “Shutter Island” is as salt-splashed and tempestuous as either of those seafaring epics. Most of the action is set in the mid-1950s. Two wisecracking federal marshals, Teddy Daniels and the felicitously named Chuck Aule, are ferried across Boston Harbour to Shutter Island, home to Ashecliffe Hospital, a former civil-war outpost turned asylum for the criminally insane. Their job is to hunt down an escaped patient, Rachel Solando, a beautiful but dangerously loopy woman (she drowned her three children before drying them off and arranging them like dolls at the breakfast table). Teddy and Chuck are convinced that Rachel could not have disappeared without inside help. And that's not the only thing that doesn't seem quite right. What goes on in the mysterious “Ward C” that everybody alludes to so darkly? Why do armed guards patrol the lighthouse? And who is the 67th patient mentioned in the coded note found in Rachel's room? There must be more to Ashecliffe Hospital than meets the eye.

No sooner have Teddy and Chuck started to snoop around than a hurricane sweeps in, knocking out the phone lines and cutting the island off from the mainland. Mr Lehane ups the suspense with plenty of creepy details. Teddy is haunted by memories of his brutal wartime experiences and the death of his wife; clues come to him in terrible visions as he sleeps; and of course the gloomy old hospital is crawling with sinister headshrinkers, a ghoulish warden and spooked orderlies.

Things get really nasty when the investigators finally bluff their way into Ward C. Not only is the place packed to the rafters with suitably Hogarthian lunatics, but there is a full-scale riot going on too. All of this is done with Mr Lehane's customary panache. What “Shutter Island” lacks in originality and depth—the qualities that made “Mystic River” stand out—it makes up for with lots of enjoyably over-the-top gothic melodrama.

Shutter Island.
By Dennis Lehane.
William Morrow; 336 pages; $25.95.
Bantam Press; £10

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About sponsorship

“The Matrix Reloaded”

May 15th 2003
From The Economist print edition

Reuters

As Neo, Keanu Reeves swirls his coat, ever the subversive superman (above); as Trinity, Carrie-Anne Moss, shrink-wrapped into an oily black catsuit, leaps into the air and freezes, a human rocket in black vinyl. With all their cybernetics, higher mathematics and high-end literary references, the Wachowski brothers' Matrix films have launched more than a thousand nerdy websites. But for the precociously fashionable, there is nothing more important than the styling. Even if you need a weapons-grade workout regime to achieve it, who wouldn't kill for a look that is so damn cool?

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Hollywood history

La nuit américaine

May 15th 2003
From The Economist print edition

RYAN GILBEY'S study of the American new wave is the first in-depth look at the subject that isn't a glorified gossip book. The author also candidly admits in the introduction that he was an infant when the films he analyses were released. His chapters on ten filmmakers of the 1970s are therefore not based on personal memories of the era nor evidently on scrupulous research designed to plug the gaps: the book is guilty of the occasional factual error. But there is something to be said for Mr Gilbey's detachment. It allows him to come at his subject with a fresh eye—and with fewer inaccuracies than the factoid-happy competition.

His theme is that directors in the 1970s challenged audiences by making them self-conscious about how they looked at films and what they wanted from them. It would be nice if some mention were made of the fact that the directors concerned were not the first to play perverse games with the audience, but Mr Gilbey is quite right when he argues that the games played by Francis Ford Coppola and his fellow filmmakers paved the way for the independent American cinema—and the most interesting television—of the 1980s and 1990s.

In any case, the book is much more than its historical argument. In his analysis of individual directors and their films, Mr Gilbey strips away the encrusted clichés by writing paradoxically about undercurrents of existentialism in “American Graffiti” and the disgust with daily life that pervades Steven Spielberg's work. “‘Jaws’ is actually about the repellent vulnerability of people,” he observes. “The shark is only a convenient means of exposing that vulnerability.” More obvious subversives are also refreshed by the Gilbey treatment, which homes in on the anxious silence at the heart of Robert Altman's ceaseless chatter and the fear of women portrayed in Harvey Keitel's performances for Martin Scorsese, polemically contrasted with the flashier machismo of Robert De Niro. Surprising rapprochements abound: Marco Ferreri and Brian De Palma, Luis Buñuel and Woody Allen, Pedro Almodóvar and Jonathan Demme (whose exploitation films for Roger Corman are given a long overdue reconsideration).

If someone ever thought to collect in a single volume all of Pauline Kael's contemporary reviews of films by new directors in the 1970s, it would have more range and cultural depth than this one, but apart from that dream work, it is hard to imagine a more stimulating book about the subject than “It Don't Worry Me”.

It Don't Worry Me: The Revolutionary Films of the Seventies.
By Ryan Gilbey.
Faber and Faber; 256 pages; $24 and £16.99

It Don't Worry Me: The Revolutionary Films of the Seventies
By Ryan Gilbey

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About sponsorship

Barbara Vernon Bailey

May 15th 2003
From The Economist print edition

Barbara Vernon Bailey, artist and nun, died on May 4th, aged 92

Royal Doulton / Nigel Acheson

PROBABLY the last thing on Barbara Vernon Bailey's mind when she was painting was money. Her main concern was whether the candle in her room would last until she had finished her picture. The English convent where Miss Bailey was a nun was not deliberately frugal, but it was careful. It could not afford electricity and candles were a luxury. However, outside the convent and its commitment to prayer and simple living was the world of the market-place. Many of the bowls, plates and mugs designed for children that featured Miss Bailey's paintings are now much sought by collectors throughout the world. A rare piece can fetch up to $3,000.

Although collecting at this level seems pretty modest when compared with the prices fetched by, say, the Impressionists, all collectors have in common the desire to find an unconsidered trifle that turns out to be a treasure. Who would have thought a few years ago that discarded children's items had a value much greater than their original cost? The BBC's “Antiques Roadshow” and similar programmes in other countries have stimulated the market. Beatrix Potter's “Peter Rabbit” mugs and dishes are market leaders. Miss Bailey's pictures were also of a rabbit family. Do not be put off by the family's whimsical name, “Bunnykins”. Miss Bailey's rabbity figures done in watercolours have great character, especially Father Rabbit, with his round spectacles and smoking a pipe, said to be modelled on Miss Bailey's father. They depict a close-knit family life that nostalgics say is a thing of the past.

A piece's value will partly depend on its condition. A dealer's catalogue reads: “Porridge bowl, with Mama Bunny; in colour; fine English bone china; no chips or cracks; signed Barbara Vernon.” To a collector this is serious stuff. Children, being natural wreckers, are disinclined to abandon a dish without leaving a few cracks in it, hence the rarity of perfect specimens.

Not surprisingly, other childish possessions once destined for the dustbin are finding their way into collections. Forget Teddy Bears. They fetch silly prices. And if you cannot run even to a Barbara Vernon Bailey, take heart: the market seems to be growing for anything to do with such recent arrivals as Paddington Bear, Thomas the Tank Engine and Postman Pat.

With the Canonesses

Barbara Vernon Bailey had a privileged upbringing. She was born in a stately home in Shropshire, and was taught by governesses. As a young woman she trained as a nurse and as a teacher. It is unclear when she experienced her call to the church, but by her early 20s she had entered a convent in Sussex, in southern England, and taken the name Sister Mary Barbara. It was run by a Roman Catholic order known as the Augustinian Canonesses of the Lateran, whose communities had existed in England since the 11th century. She taught history and French at the school attached to the convent. Otherwise she was confined to the convent. The Canonesses were an “enclosed” order: visitors, even members of her family, were allowed to see her only through a prison-like grille. Such encounters did not encourage easy conversation. To pass the time on one of his visits Miss Bailey's father recalled that as a child she had shown a prodigious talent sketching the animals in the farm attached to their Shropshire home. He gave her some paper and paints. Why didn't she do some paintings that on later visits he could take home with him to show to his friends?

Her father was general manager of Doulton, a manufacturer of chinaware. He decided that some of his

daughter's paintings would look good on the firm's children's items. They became so popular that soon a major part of the firm's production was given over to Bunnykins. The young English princesses, Elizabeth and Margaret, sipped their morning milk from Bunnykins mugs.

The prioress at the convent seems not to have been a Bunnykins fan. She was concerned that other nuns might find their time taken up with “little things” when they should be at prayer. She decided that the convent should not accept money for Miss Bailey's work, even though it was hard up. Miss Bailey herself was not excused from devotions. She was only able to paint late at night when the rest of the community was asleep, or before it awoke at five in the morning for the first prayers.

Eventually, though, exhaustion persuaded Miss Bailey to stop painting. In all, she painted around 1,000 pictures, most of which have been documented by enthusiasts in Bunnykins clubs that exist in half a dozen countries, including the United States and Australia. A British club publishes the *Bunnykins News* six times a year. The characters' appeal seems to be growing. On June 7th BBC Radio 4 is aiming to burrow deep into the rabbity phenomenon with a programme entitled “The Bunnykins Business”.

Miss Bailey returned to painting later in life. Our pictures show her as a young nun in a wimple and in her mature years. Her order became less restrictive after changes introduced by the Vatican in the 1960s. She said she was pleased that her characters had provided so much pleasure to children, albeit of a secular kind. One regret was that Doulton showed no interest in another of her characters: an engaging family of ducks.

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Overview

May 15th 2003
From The Economist print edition

American retail sales fell in value by 0.1% in April, disappointing forecasters and making many reconsider their expectations for the economy. America's merchandise-trade deficit widened to $47.1 billion in March; the 12-month total rose to $514.3 billion, up from $420.7 billion a year ago.

Germany's GDP shrank by 0.9% in the first quarter at an annual rate; year-on-year, GDP grew by only 0.2%. Italy's GDP also shrank by 0.4% at an annual rate in the first quarter.

The news from the **euro area's** factories is also gloomy. In the year to March, **industrial production** fell by 0.4% in **Germany**, and by 0.7% in **Italy**. **France's** industrial output rose by a meagre 0.5% in the year to March.

Two **euro-area** economies saw a drop in their rates of inflation. In the year to April, **Germany's** consumer-price index rose by only 1.0%, down from 1.5% in the previous year. But, also in the year to April, German producer prices rose by 0.3%, though in the month of April alone they actually fell. In **Spain**, consumer prices rose by 3.1% in the year to April, down from 3.6% last year.

Consumer prices in **Denmark** rose by 2.5% in the year to April, up from 2.4% in the previous year. More Danes are on the dole, as the unemployment rate rose to 5.8% in March, up from 5.0% a year ago. In **Sweden**, inflation was 2.3% in the year to April, down a bit from the 2.5% in the previous year.

Retail sales in **Canada** rose in volume by 2.2% in the year to February.

Industrial production in **Britain** is still in the doldrums. In the year to March, it fell by 0.8%. Producer prices fell by 0.1% in April, rather than rising as expected, giving a 12-month increase of 1.7%. Wages rose by 3.4% in the year to March. That was thanks in part to companies paying their annual bonuses later in the first quarter compared with last year.

Japan's broad money supply growth continues to slow. The growth rate fell to 1.4% in the year to April, from 1.8% last month and down from 3.6% a year earlier. The country's 12-month trade surplus narrowed slightly to $94.7 billion in March, and its current- account surplus also fell to $109.9 billion from $114.3 billion in February.

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Output, demand and jobs

May 15th 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.0	Q4	+ 1.6	+ 3.0	+ 3.5	+ 2.3	Q4	+ 4.0	Q1	6.1	Apr	6.3
Austria	+ 1.3	Q4	– 0.5	+ 0.9	+ 1.8	– 1.5	Dec	+ 0.9	Dec	4.3	Mar	4.0
Belgium	+ 1.7	Q4	+ 1.2	+ 1.1	+ 2.1	– 1.6	Feb	– 5.3	Feb	11.6	Apr†	10.5
Britain	+ 2.3	Q1	+ 0.7	+ 1.8	+ 2.4	– 0.8	Mar	+ 4.3	Mar	5.1	Mar††	5.1
Canada	+ 3.9	Q4	+ 1.6	+ 2.7	+ 3.2	+ 1.9	Feb	+ 2.2	Feb	7.5	Apr	7.6
Denmark	+ 0.9	Q4	– 0.1	+ 1.5	+ 2.2	– 1.6	Mar	+ 5.8	Feb	5.8	Mar	5.0
France	+ 1.5	Q4	– 0.3	+ 1.2	+ 2.1	+ 0.5	Mar	– 0.8	Feb	9.3	Mar	8.9
Germany	+ 0.2	Q1	– 0.9	+ 0.4	+ 1.5	– 0.4	Mar	– 4.0	Mar	10.7	Apr§	9.6
Italy	+ 0.8	Q1	– 0.4	+ 1.0	+ 1.9	– 0.7	Mar	+ 0.8	Feb‡	9.0	Jan	9.0
Japan	+ 2.8	Q4	+ 2.2	+ 0.7	+ 0.8	+ 3.8	Mar	– 0.2	Feb	5.4	Mar	5.3
Netherlands	– 0.3	Q1	– 1.2	+ 0.5	+ 1.6	– 1.6	Feb	– 2.5	Dec	4.9	Mar**	3.7
Spain	+ 2.1	Q4	+ 1.4	+ 2.1	+ 2.6	+ 9.5	Mar	+ 2.3	Feb	11.5	Mar	11.2
Sweden	+ 1.3	Q4	+ 1.2	+ 1.5	+ 2.3	– 1.8	Feb	+ 2.6	Mar	4.6	Mar†	3.8
Switzerland	+ 0.8	Q4	+ 1.4	+ 0.8	+ 1.6	– 2.1	Q4	– 1.3	Jan	3.9	Apr†	2.5
United States	+ 2.1	Q1	+ 1.6	+ 2.2	+ 3.2	+ 0.4	Mar	+ 4.6	Mar	6.0	Apr	5.9
Euro area	+ 1.3	Q4	+ 0.7	+ 1.1	+ 2.1	+ 1.8	Feb	+ 0.7	Feb	8.7	Mar	8.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.8	Q4	+ 2.8	na	na	– 2.0	Mar	+ 5.1	Jan	9.9	Mar†	9.5
Greece	+ 3.5	Q4	na	na	na	+ 0.8	Mar	na		na		na
Iceland	– 3.0	Q4	na	na	na	– 0.3	2002	na		3.9	Apr†	2.6
Ireland	+ 6.4	Q4	na	na	na	+14.3	Feb	– 2.0	Feb	4.6	Apr	4.2
Luxembourg	+ 1.0	2001	na	na	na	+ 3.1	Jan	+ 9.7	Dec	3.7	Mar	2.8
New Zealand	+ 4.2	Q4	+ 2.0	na	na	+ 5.9	Q4	+ 7.3	Q4	4.9	Q4	5.4
Norway	– 0.1	Q4	+ 0.9	na	na	+ 9.0	Mar	+ 0.9	Mar	4.4	Q1	4.1
Portugal	– 1.3	Q4	– 3.1	na	na	– 4.5	Mar	+ 2.3	Feb	6.2	Q4†	4.2

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Jan-Mar; claimant count rate 3.1% in Apr. §EU harmonised rate 9.4% in April. **Jan-Mar, new series.

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Prices and wages

May 15th 2003
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 3.4	Q1	+ 2.9	+ 2.7	+ 2.5	+ 3.0	Q1	+ 0.5	+ 3.9	Q4	+ 4.9
Austria	+ 1.8	Mar	+ 1.9	+ 1.5	+ 1.3	+ 0.8	Apr	– 0.5	+ 2.2	Mar	+ 2.4
Belgium	+ 1.5	Apr	+ 1.8	+ 1.4	+ 1.4	+ 0.8	Mar	– 0.9	+ 2.4	Q1	+ 3.1
Britain	+ 3.1	Mar	+ 1.3	+ 2.8	+ 2.4	+ 1.7	Apr	+ 0.2	+ 3.4	Mar	+ 2.9
Canada	+ 4.3	Mar	+ 1.8	+ 3.1	+ 2.2	+ 1.3	Mar	– 1.0	+ 2.1	Feb	+ 3.5
Denmark	+ 2.5	Apr	+ 2.4	+ 2.3	+ 1.9	+ 0.7	Mar	+ 0.8	+ 3.9	Q4	+ 4.1
France	+ 2.6	Mar	+ 2.1	+ 1.8	+ 1.4	+ 2.5	Mar	– 0.8	+ 3.5	Q4	+ 3.9
Germany	+ 1.0	Apr	+ 1.5	+ 1.1	+ 0.9	+ 0.3	Apr	– 0.5	+ 2.6	Feb	+ 2.5
Italy	+ 2.7	Apr	+ 2.3	+ 2.3	+ 1.9	+ 2.8	Mar	– 0.8	+ 1.7	Mar*	+ 2.1
Japan	– 0.1	Mar	– 1.2	– 0.6	– 0.5	– 0.7	Mar	– 2.5	+ 2.5	Mar	– 0.9
Netherlands	+ 2.5	Apr	+ 3.5	+ 2.5	+ 2.1	+ 3.5	Mar	– 1.7	+ 2.8	Mar	+ 4.4
Spain	+ 3.1	Apr	+ 3.6	+ 3.0	+ 2.6	+ 3.0	Mar	– 0.1	+ 3.9	Q4	+ 3.7
Sweden	+ 2.3	Apr	+ 2.5	+ 2.4	+ 1.8	+ 0.6	Mar	– 0.4	+ 2.1	Feb	+ 3.3
Switzerland	+ 0.7	Apr	+ 1.1	+ 0.8	+ 0.9	+ 0.3	Mar	– 1.3	+ 1.8	2002	+ 2.5
United States	+ 3.0	Mar	+ 1.5	+ 2.3	+ 1.7	+ 4.2	Mar	– 1.6	+ 3.1	Apr	+ 3.2
Euro area	+ 2.1	Apr	+ 2.3	+ 1.9	+ 1.5	+ 2.4	Mar	– 0.8	+ 3.4	Q4	+ 3.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.1	Apr	+ 1.8	na	na	+ 0.8	Mar	– 0.8	+ 3.3	Q4	+ 4.5
Greece	+ 4.1	Mar	+ 4.0	na	na	+ 2.0	Mar	+ 4.2	na		na
Iceland	+ 2.2	May	+ 5.9	na	na	+ 3.3	Apr	+ 8.7	+ 5.7	Mar	+ 8.7
Ireland	+ 4.9	Mar	+ 4.8	na	na	– 7.1	Mar	+ 0.7	+ 6.8	Q4	+ 7.8
Luxembourg	+ 2.2	Apr	+ 2.1	na	na	+ 2.3	Feb	– 2.4	– 1.4	Jan	+ 1.9
New Zealand	+ 2.5	Q1	+ 2.6	na	na	– 0.9	Q4	+ 1.8	+ 2.3	Q1	+ 2.1
Norway	+ 2.9	Apr	+ 0.5	na	na	+ 5.1	Mar	– 4.5	+ 5.2	Q4	+ 4.4
Portugal	+ 3.9	Mar	+ 3.2	na	na	+ 2.1	Mar	– 0.4	+ 0.6	Feb	+ 0.6

*New series.

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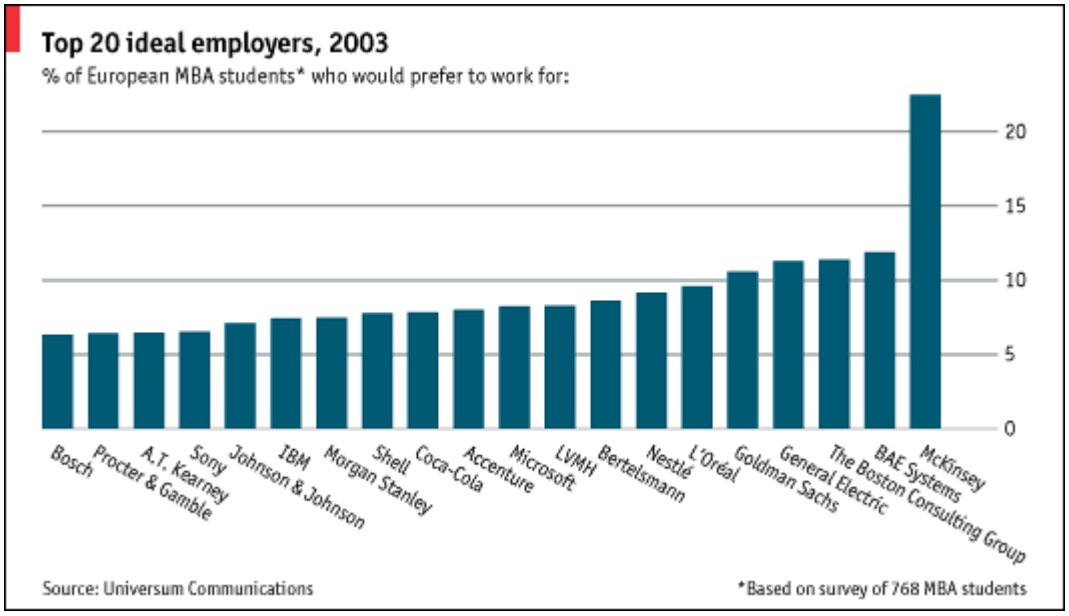
Top 20 ideal employers, 2003

May 15th 2003
From The Economist print edition



The company that Europe's MBA students would most like to work for is McKinsey, a big management consultancy, according to a survey of 16 business schools by Universum Communications. It is twice as popular as any other employer. Other management consultancies, including the Boston Consulting Group, Accenture and A.T. Kearney, also score high on the list. American companies account for 12 of the top 20.

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Money and interest rates

May 15th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (May 14th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	−10.0	+10.6	Mar	4.78	4.87	4.56	5.10	6.35	5.96
Britain	+ 6.3	+ 7.2	Mar	3.63	4.09	3.46	4.20	5.30	5.79
Canada	+ 7.0	+ 4.9	Mar	3.21	2.54	3.55	4.81	5.76	6.61
Denmark	+ 8.2	+ 9.2	Mar	2.70	3.80	2.49	4.10	5.41	5.35
Japan	+ 4.7	+ 1.4	Apr	0.02	0.02	0.05	0.58	1.35	0.68
Sweden	+ 2.2	+ 5.9	Mar	3.26	4.28	3.26	4.36	5.66	3.73
Switzerland	+24.0	+10.0	Mar	0.30	1.28	0.32	2.27	3.32	3.23
United States	+ 4.0	+ 6.4	Mar	1.21	1.81	1.36	3.52	5.25	5.54
Euro area†	+11.6	+ 7.9	Mar	2.43	3.49	2.26	3.86	5.18	4.00

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.51%, Japan No.249 0.58%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.50%, BOJ overnight call 0.002%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

May 15th 2003
From The Economist print edition

1995=100

	May 6th	May 13th*	% change on one month	% change on one year
Dollar index				
All items	75.5	77.3	+ 1.7	+12.2
Food	78.0	80.2	+ 3.4	+16.8
Industrials				
All	71.9	73.3	– 0.8	+ 6.2
Nfa†	74.3	74.3	– 5.8	+ 6.4
Metals	70.0	72.5	+ 4.1	+ 5.9
Sterling index				
All items	73.7	75.8	– 0.7	+ 1.0
Euro index				
All items	87.5	88.2	– 4.7	–12.2
Yen index				
All items	94.7	95.9	– 1.4	+ 1.7
Gold				
$ per oz	342.90	350.70	+ 8.5	+14.0
West Texas Intermediate				
$ per barrel	25.73	28.57	– 2.7	– 1.8

* Provisional. † Non-food agriculturals.

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Stockmarkets

May 15th 2003
From The Economist print edition

Market indices

	May 14th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	2,943.0	3,049.6	2,673.3	nil	-14.4	- 1.1	+13.7
Austria (ATX)	1,320.7	1,320.7	1,120.2	+ 1.7	-24.0	+14.8	+25.8
Belgium (Bel 20)	1,930.3	2,074.1	1,426.6	- 0.5	-47.6	- 4.7	+ 4.4
Britain (FTSE 100)	3,975.0	4,009.5	3,287.0	- 0.4	-42.6	+ 0.9	+ 1.5
Canada (Toronto Composite)	6,742.4	6,837.3	6,228.6	+ 1.4	-40.8	+ 1.9	+16.7
Denmark (KBX)	177.0	177.8	145.0	+ 0.7	-41.3	+ 6.5	+16.7
France (SBF 250)	2,003.6	2,144.8	1,630.1	- 1.6	-54.4	- 2.4	+ 6.9
(CAC 40)	2,961.8	3,210.3	2,403.0	- 2.1	-57.2	- 3.3	+ 5.9
Germany (DAX)	2,926.0	3,157.3	2,203.0	- 2.6	-63.7	+ 1.2	+10.8
Italy (BCI)	1,121.7	1,142.4	959.4	- 0.9	-48.6	+ 2.7	+12.5
Japan (Nikkei 225)	8,244.9	8,790.9	7,607.9	+ 1.7	-78.8	- 3.9	- 1.9
(Topix)	832.0	865.4	770.6	+ 1.1	-71.2	- 1.3	+ 0.7
Netherlands (AEX)	282.2	337.3	218.4	- 1.3	-59.8	-12.6	- 4.3
Spain (Madrid SE)	666.2	684.6	576.8	- 0.8	-41.9	+ 5.1	+15.1
Sweden (Affarsvarlden Gen)	150.8	153.4	127.8	+ 0.6	-62.3	+ 3.9	+13.4
Switzerland (Swiss Market)	4,546.6	4,965.3	3,675.4	- 1.8	-46.0	- 1.8	+ 3.3
United States (DJIA)	8,647.8	8,842.6	7,524.1	+ 1.0	-26.2	+ 3.7	+ 3.7
(S&P 500)	939.3	945.1	800.7	+ 1.0	-38.5	+ 6.8	+ 6.8
(NASDAQ Comp)	1,534.9	1,541.4	1,271.5	+ 1.9	-69.6	+14.9	+14.9
Europe (FTSE Eurotop 300)*	817.2	890.8	682.7	- 1.3	-52.1	- 4.6	+ 4.4
Euro area (FTSE Ebloc 100)*	696.9	757.2	565.7	- 1.8	-55.1	- 3.0	+ 6.2
World (MSCI)†	838.0	840.0	710.8	+ 0.9	-42.2	na	+ 5.8
World bond market (Citigroup)‡	565.6	565.6	518.6	+ 1.1	+ 1.9	na	+ 7.7

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

May 15th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		The Economist poll % of GDP, forecast 2003	2004	Exchange rate trade-weighted† 1990=100 May 14th	year ago	Currency units per $ May 14th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2003‡
Australia	− 7.8	Mar	− 17.7	Q4	− 4.7	− 4.0	80.8	76.8	1.55	1.82	2.50	1.78	1.33	0.2
Austria	+ 0.7	Feb	+ 1.4	Feb	− 0.1	− 0.2	102.0§	100.1	0.87	1.10	1.41	–	0.75	-1.3
Belgium	+ 17.4	Feb	+ 11.4	Jan	+ 5.0	+ 5.0	102.0§	98.8	0.87	1.10	1.41	–	0.75	nil
Britain	− 56.8	Mar	− 13.1	Q4	− 1.6	− 1.4	98.1	106.0	0.62	0.69	–	0.71	0.53	-1.9
Canada	+ 36.4	Mar	+ 11.0	Q4	+ 1.5	+ 1.6	84.6	77.3	1.38	1.56	2.24	1.59	1.19	1.1
Denmark	+ 8.7	Mar	+ 5.5	Mar	+ 2.3	+ 2.2	106.5	102.2	6.46	8.20	10.5	7.42	5.56	1.6
France	+ 8.4	Mar	+ 28.3	Feb	+ 1.8	+ 1.5	105.2§	101.4	0.87	1.10	1.41	–	0.75	-3.6
Germany	+123.0	Mar	+ 48.0	Mar	+ 1.9	+ 1.6	102.5§	98.2	0.87	1.10	1.41	–	0.75	-3.7
Italy	+ 7.5	Feb	− 9.6	Feb	− 0.3	− 0.3	75.0§	72.3	0.87	1.10	1.41	–	0.75	-2.4
Japan	+ 94.7	Mar	+109.9	Mar	+ 2.7	+ 2.9	130.7	130.7	116	128	188	134	–	-7.7
Netherlands	+ 28.5	Mar	+ 9.1	Q4	+ 3.1	+ 3.1	101.4§	97.7	0.87	1.10	1.41	–	0.75	-1.6
Spain	− 42.0	Feb	− 17.4	Jan	− 2.2	− 2.1	76.4§	74.1	0.87	1.10	1.41	–	0.75	-0.4
Sweden	+ 15.2	Mar	+ 9.9	Dec	+ 3.6	+ 3.5	80.5	75.7	7.98	10.2	12.9	9.17	6.86	0.7
Switzerland	+ 4.8	Mar	+ 32.0	Q4	+11.7	+11.7	114.6	113.8	1.31	1.61	2.13	1.51	1.13	na
United States	−514.3	Mar	−503.4	Q4	− 5.3	− 5.4	102.7	119.6	–	–	1.62	1.15	0.86	-4.6
Euro area	+ 95.6	Feb	+ 53.1	Feb	+ 0.8	+ 0.7	90.2	79.2	0.87	1.10	1.41	–	0.75	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.5	Feb	+ 10.1	Feb	na	na	81.0§	77.8	0.88	1.10	1.43	–	0.76	3.1
Greece	− 22.3	Feb	− 10.8	Feb	na	na	59.0§	57.4	0.88	1.10	1.43	–	0.76	-1.0
Iceland	+ 0.2	Mar	nil	Q4	na	na	96.0**	84.9	73.7	92.3	119	84.7	63.4	nil
Ireland	+ 36.3	Feb	− 0.2	Q4	na	na	93.0§	86.9	0.88	1.10	1.43	–	0.76	-0.8
Luxembourg	− 3.0	Jan	+ 1.7	Q4	na	na	102.0§	98.8	0.88	1.10	1.43	–	0.76	0.2
New Zealand	− 0.9	Mar	− 1.9	Q4	na	na	97.2	87.0	1.77	2.18	2.87	2.03	1.52	0.8
Norway	+ 28.1	Mar	+ 28.1	Feb	na	na	102.3	101.9	6.92	8.32	11.2	7.95	5.95	11.3
Portugal	− 12.5	Feb	− 8.8	Feb	na	na	92.2**	90.1	0.88	1.10	1.43	–	0.76	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, March average. ‡OECD forecast. **IMF, January average.

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Exchange-rate forecasts

May 15th 2003
From The Economist print edition

Exchange-rate forecasts

from J.P. Morgan Chase, currency units per $

	May 14th	3-month	12-month
Euro area*	1.15	1.17	1.25
Japan	116.3	117.0	115.0
Australia	1.55	1.54	1.43
Britain†	1.62	1.63	1.67
Canada	1.38	1.38	1.30
Denmark	6.46	6.40	5.95
Sweden	7.98	7.65	7.00
Switzerland	1.31	1.30	1.23
China	8.28	8.27	8.23
Singapore	1.73	1.71	1.72
South Korea	1,198	1,150	1,250
Brazil	2.89	3.20	3.40
Mexico	10.2	10.5	10.7
Poland	3.77	3.70	3.30
Russia	31.0	31.5	31.7
South Africa	7.56	7.00	9.00

*$ per € †$ per £

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Overview

May 15th 2003
From The Economist print edition

The outlook for Latin American economies looks brighter. **Chile's** economy grew by 3.5% in the year to the first quarter, its fastest for almost two years. Industrial production rose by 3.8% in **Mexico** in the 12 months to March, its fastest for almost a year. In **Venezuela**, inflation abated a little.

Inflationary pressures eased in two of the countries that are due to join the EU next year. In **Hungary**, prices rose by 3.9% in the year to April, a 22-year low. In **Poland**, inflation over the same period fell to just 0.3%. In the **Czech Republic**, another accession country, industrial output rose by 7.0% in the 12 months to March.

In **South Africa**, industrial production fell by 0.7% in the year to March, the first annual decline for 18 months.

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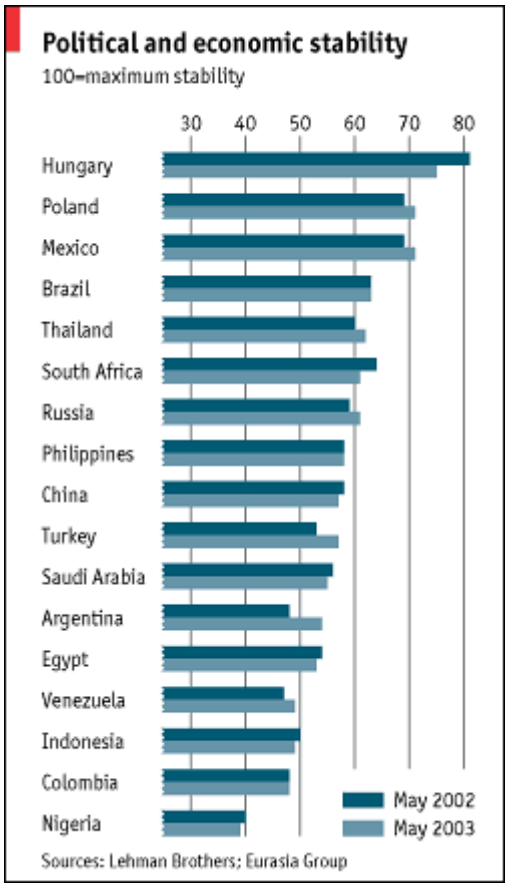
Political and economic stability

May 15th 2003
From The Economist print edition

Hungary remains one of the stablest emerging economies, according to an index produced by Lehman Brothers and Eurasia Group, a firm that analyses political risk. The index seeks to measure a country's ability to withstand crises and to avoid generating them. At 75 (out of a maximum score of 100) Hungary's perceived stability places it just ahead of Poland and Mexico, both of which score 71. Venezuela and Argentina, two Latin American countries that have recently suffered big economic crises, have both become stabler since last year, according to the index.



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Economy

May 15th 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q1	+16.9	Mar	+ 0.9	Mar	+22.0	Apr	+33.5	2002†	312.9	Feb
Hong Kong	+ 5.0	Q4	– 9.2	Q4	– 2.1	Mar	– 8.0	Mar	+13.8	Q4	114.2	Apr
India	+ 2.6	Q4	+ 6.4	Feb	+ 4.1	Mar	– 9.0	Mar	+ 4.8	Q4	71.1	Mar
Indonesia	+ 3.8	Q4	+29.2	Feb	+ 7.5	Apr	+25.6	Mar	+ 7.5	Q3	31.6	Mar
Malaysia	+ 5.6	Q4	+ 5.0	Mar	+ 0.7	Mar	+14.7	Mar	+ 7.3	Q4	33.8	Mar
Philippines	+ 5.8	Q4	+ 1.8	Feb	+ 2.8	Apr	+ 0.2	Feb	+ 4.2	Dec	13.1	Apr
Singapore	+ 1.5	Q1	+ 6.5	Mar	+ 0.8	Mar	+11.1	Mar	+18.7	Q4	83.4	Apr
South Korea	+ 6.8	Q4	+ 4.5	Mar	+ 3.7	Apr	+ 8.0	Apr	+ 2.9	Mar	123.8	Mar
Taiwan	+ 4.2	Q4	+ 1.6	Mar	– 0.1	Apr	+16.5	Apr	+25.8	Q4	168.6	Mar
Thailand	+ 6.1	Q4	+12.7	Mar	+ 1.6	Apr	+ 3.9	Mar	+ 8.5	Mar	36.8	Mar
Argentina	– 3.6	Q4	+15.8	Mar	+19.4	Apr	+16.7	Mar	+ 8.9	Q4	11.0	Apr
Brazil	+ 3.4	Q4	+ 3.5	Mar	+16.7	Mar	+17.1	Apr	– 4.4	Mar	42.3	Mar
Chile	+ 3.5	Q1	+ 6.9	Mar	+ 4.0	Apr	+ 2.5	Mar	– 0.6	Q4	16.1	Mar
Colombia	+ 2.0	Q4	+ 5.0	Feb	+ 7.8	Apr	nil	Dec	– 1.6	Q4	10.5	Mar
Mexico	+ 1.9	Q4	+ 3.8	Mar	+ 5.3	Apr	– 6.7	Mar	–14.5	Q4	53.7	Apr
Peru	+ 5.3	Feb	+ 4.2	Feb	+ 2.6	Apr	+ 0.4	Feb	– 1.1	Q4	9.8	Mar
Venezuela	–16.7	Q4	–64.8	Dec	+33.5	Apr	+13.9	Q4	+ 7.6	Q4	8.4	Feb
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.1	Feb	– 7.4	Jan	+ 0.5	Q4	13.2	Dec
Israel	+ 1.3	Q4	+ 3.0	Jan	+ 4.8	Mar	– 5.8	Apr	– 2.1	Q4	23.4	Apr
South Africa	+ 3.0	Q4	– 0.7	Mar	+12.5	Mar	+ 3.6	Mar	+ 0.3	Q4	6.1	Mar
Turkey	+11.4	Q4	+ 5.6	Mar	+29.5	Apr	–16.4	Feb	– 2.7	Feb	27.9	Feb
Czech Republic	+ 1.5	Q4	+ 7.0	Mar	– 0.1	Apr	– 2.6	Mar	– 3.5	Q4	24.7	Mar
Hungary	+ 3.7	Q4	+ 4.2	Mar	+ 3.9	Apr	– 2.5	Mar‡	– 3.3	Mar	13.6	Mar
Poland	+ 2.1	Q4	+ 5.7	Mar	+ 0.3	Apr	– 9.9	Mar	– 5.8	Mar	30.0	Mar
Russia	+ 5.2	Q4	+ 6.7	Mar	+14.7	Apr	+52.2	Mar	+38.3	Q1	51.8	Mar
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	+15.8	Nov	+ 2.2	Apr	– 1.5	Apr	+ 2.7	2002†	10.3	Mar
Saudi Arabia	+ 0.7	2002†	na		– 0.9	Jan	+38.6	2002†	+ 9.5	2002†	21.2	Jan

*Excluding gold, except Singapore; IMF definition. †EIU est. †Year ending June. ‡New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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Financial markets

May 15th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	May 14th		Dec 31st 2002	
	May 14th	year ago	May 14th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.4	na	1,595.0	+0.2	+ 12.4	+ 12.4
Hong Kong	7.80	7.80	12.6	1.41	9,103.7	+2.3	– 2.3	– 2.3
India	47.1	49.0	76.3	4.94	2,993.9	+0.4	– 11.4	– 9.8
Indonesia	8,450	9,240	13,692	11.38	467.9	–1.1	+ 10.1	+ 16.6
Malaysia	3.80	3.80	6.16	3.10	635.8	+0.6	– 1.6	– 1.6
Philippines	52.0	49.6	84.3	8.06	1,061.6	–1.5	+ 4.2	+ 7.0
Singapore	1.73	1.81	2.80	0.66	1,311.0	+0.3	– 2.2	– 2.0
South Korea	1,198	1,273	1,940	4.41	610.0	–1.3	– 2.8	– 3.7
Taiwan	34.7	34.5	56.1	1.25	4,341.1	+1.5	– 2.5	– 2.2
Thailand	42.1	42.9	68.3	1.75	385.2	+1.5	+ 8.1	+ 10.5
Argentina	2.77	3.24	4.48	6.20	630.6	–1.5	+ 20.1	+ 46.0
Brazil	2.89	2.51	4.68	26.32	13,459.4	+3.9	+ 19.4	+ 46.5
Chile	697	653	1,130	3.12	5,877.3	+3.0	+ 17.1	+ 20.9
Colombia	2,817	2,300	4,564	7.76	1,808.5	+3.2	+ 12.4	+ 14.4
Mexico	10.15	9.48	16.4	7.56	6,549.8	–0.4	+ 6.9	+ 10.2
Peru	3.48	3.45	5.63	3.74	1,779.4	–0.1	+ 27.8	+ 29.3
Venezuela	1,598	1,001	2,589	22.63	8,764.5	+2.5	+ 9.3	– 5.1
Egypt	5.96	4.60	9.65	12.54	7,426.2	–0.6	+ 38.3	+ 7.5
Israel	4.48	4.80	7.25	5.51	416.8	+1.8	+ 25.4	+ 33.1
South Africa	7.6	10.2	12.3	13.60	8,035.2	+4.5	– 13.4	– 1.7
Turkey	1,486,000	1,395,500	2,407,766	39.00	10,393.3	–2.7	+ 0.2	+ 12.0
Czech Republic	27.4	33.4	44.4	2.46	546.3	+1.2	+ 18.6	+ 30.1
Hungary	213	269	345	6.46	8,163.4	–0.6	+ 4.7	+ 10.5
Poland	3.77	4.08	6.10	5.55	15,012.2	+3.5	+ 4.5	+ 6.4
Russia	31.0	31.3	50.2	18.00	437.4‡	+3.3	+ 18.1	+ 21.8
EMF (MSCI)*	1.00	1.00	1.62	na	305.0	+0.9	na	+ 4.4
EMBI+†	1.00	1.00	1.62	na	270.8	+1.7	na	+ 18.3

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

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